

SEGIR – FS
INITIATIVE
IN
BANK REFORM IN RUSSIA

FINAL REPORT

AUGUST 14, 2001

Prepared by

Philip W. Smith
Resident Advisor
Development Alternatives, Inc.

USAID/Russia
Contract number PCE-I-00-99-00009-00 (SEGIR-FS)
Task Order number 802
Contractor: Development Alternatives, Inc.

Table of Contents

Executive Overview

Introduction and Background

Work Plan

Completion of the Work Plan

Coordination with other Projects and Technical Assistance Donors

Knowledge Transfer

Training Completed

Success of the Project

Description of the Tangible Results and Benchmarks Met

Recommendations to USAID

Attachments

Executive Overview

The following is an overview of the results of a technical assistance project designed to help restore the integrity of Russia's banking sector and substantially contribute to its medium term stability. This project was carried out under the auspices of the United States Agency for International Development (USAID)

The existing Russian accounting and reporting rules for banks do not allow for financial transparency. By preparing financial information and reports in compliance with International Accounting Standards (IAS), banks can decisively improve the quality of reporting and substantially help to make financial accounting and reporting transparent to domestic and international investors.

At the beginning of the project, the Central Bank of Russia (CBR) was not convinced of the necessity to require commercial banks to follow IAS. Russian law requires businesses to follow Russian Accounting Standards (RAS). Income and other taxes are based on RAS. Following IAS would require that banks operate two accounting systems. There were legal issues that hampered the conversion to IAS.

In the last year, the banking sector in Russia, led by the CBR, has made progress in understanding and using International Accounting Standards.

This Resident Technical Advisor (TA) worked with executive management at the CBR, explaining the need for transparency in the banking system and the benefits to international trade and investment of using IAS, an accounting system understood by foreign businesses. This TA recommended that the CBR require IAS compliant reports from banks and establish a transition timeline for implementation. This would be legal, feasible, and a first step in the process for providing IAS compliant financial statements to international banks and investors. It would not require two sets of books, rather a transformation from RAS to IAS for reporting purposes. The CBR adopted this recommendation that subsequently became a part of the published mid-term economic policy of the CBR and the Government of the Russian Federation.

Not only has the CBR set a deadline for requiring banks to present financial reports under IAS, it has begun reporting in IAS itself. At their request, this TA assisted the CBR with the methodology to prepare consolidated financial statements of its subsidiaries and investments that would be IAS compliant.

Over the course of this project, the CBR asked this TA to review 30 proposed CBR regulations for compliance with IAS. Those that he deemed non-compliant have not been issued. After extensive consultation and review, one set of instructions and formats for Cash Flow Statement Preparation was approved by the CBR and placed in effect in early 2001. These instructions are in compliance with IAS.

Using a new set of accounting rules requires training on those rules, both for the commercial banks and for the CBR staff. During the project, the TA conducted extensive training in Moscow and various regions in Russia. More than 370 participants attended twelve IAS workshops where the differences between RAS and IAS and the proper use of IAS in preparing financial statements were presented. In addition, more than 150 participants were involved in lectures, roundtables and accounting issue discussions during the project.

In working with three pilot banks, Probusinessbank in Moscow, NBD Bank in Nizhny Novgorod, and Center-invest in Rostov-on-Don, the TA and another Short Term Technical Advisor established that any bank that is in compliance with RAS could successfully generate IAS financial statements. It is not difficult, but it does require a database management program, e.g., Excel, and the preparer of the transformed statements must understand IAS.

Progress has been positive. The CBR has adopted some of the ideas presented by the project team members. The process of converting commercial banks to IAS has moved forward within the constraints of the law of the Russian Federation. Timelines have been established and published. Some commercial banks have the capability to internally prepare financial statements compliant with IAS.

Introduction and Background

The August 1998 financial crisis in Russia caused the public, including domestic and foreign businesses, to lose confidence in the financial sector of the economy. The Central Bank of the Russian Federation (CBR) recognized the need to improve banking supervision and the accounting system used by the banks.

In March 1999, the CBR established the Inter-Agency Coordinating Committee (IACC) under its chairmanship to ensure that technical assistance from donors and other sources of financing was used effectively to address major banking reform issues. The Committee is composed of representatives of the CBR, the Ministry of Finance, the Agency for Bank Restructuring (ARCO), commercial banks, the United States Agency for International Development (USAID), the International Monetary Fund (IMF), World Bank (WB), and EU/Tacis. The IACC has several working groups that address the priority areas of banking reform; Steering, Bank Reporting, Accounting, and Training.

The Working Group on Improving Accounting in the Banking Sector (AWG) was established at the first IACC meeting. The AWG is chaired by the Chief Accountant of the CBR and mission representatives of IMF/WB.

The joint IMF/WB mission identified substantial discrepancies between Russian Accounting Standards (RAS) and International Accounting Standards (IAS), which are understood by foreign investors. The preliminary work of the AWG revealed deep-rooted misunderstandings of very basic IAS concepts and principles. There was reluctance on the part of the Central Bank to require Russian banks to change to IAS when the country was already operating under RAS.

Using the analysis, the IACC working groups outlined terms of reference for technical assistance programs in accounting and reporting requirements for commercial banks. The general purpose of this technical assistance project is to restore the internal and external confidence in the Russian banking sector and substantially contribute to its medium-term stability.

The general purpose of this USAID technical assistance project was to result from the combination of the following specific objectives.

- ❖ To increase the usefulness of bank accounting reports, i.e., their faithfulness, relevance and credibility.
- ❖ To contribute to the improvement of the off-site supervisory capacity of the CBR through the provision of fairer, clearer, more comprehensive and relevant information.
- ❖ To help restore the integrity of Russia's interbank and financial markets, which rely on credibility and transparency of financial information exchanged by its participants, and

- ❖ To help willing banks increase the value of their accounting function and improve their financial management capacity, and promote the development of banking activities.

During the third quarter of 2000, the CBR began a sixteen-month technical assistance project in bank accounting reform with Tacis. The Tacis contractor, PricewaterhouseCoopers, is working with six pilot banks. The USAID contractor, DAI, worked with three pilot banks during the project. The Tacis and USAID contractors are working under virtually the same terms of reference.

Work Plan

A work plan was developed based on the technical assistance support agreed by USAID. There were two components within the program strategy. Task A required support to the Reporting Committee, the Technical Accounting Committee and the Training Committee of the IACC on Accounting Reform. Task B required organization and conducting accounting pilot projects at selected commercial banks. The work plan included a timetable for accomplishing the work within a one-year period beginning in February 2000.

Task A had a technical component that began with the collection and analysis of existing accounting regulations and comparison of Russian Accounting Standards (RAS) to IAS. The analysis included influencing regulations such as the Tax Code, the Civil Code, and Ministry of Finance (MinFin) regulations that affect preparation of commercial bank financial statements. The first phase also included an analysis of Russian banks' business environment. Coordination with experts to the IACC and other accounting reform projects in Russia was also a part of this component.

When the initial analysis was completed, proposals were prepared to address specific concerns of the CBR that included recommendations for adoption of amendments to existing accounting regulations and the procedures necessary to achieve the proposed amendments. Other proposals included the development of a transitional time-line to switch to IAS while complying with existing laws and regulations.

Within the technical component was work toward the revision and design and subsequent implementation of a revised set of CBR reports. The project Technical Advisors were to work with the CBR to develop new regulations to implement recommended changes for the transition to IAS.

Task A also had a training component. The initial step was an analysis of the level of knowledge and training needed at the CBR accounting methodology group and bank supervision with regard to IAS. The analysis also included members of MinFin and Ministry of Tax (MinTax) and the ARCO group. Existing training materials were to be reviewed for adaptation for CBR, MinFin and commercial bank usage.

Specific training in IAS for members of the CBR accounting methodology unit was the first step. Case studies were developed from experiences of commercial banks. There was also some "Training of Trainers" and presentations to members of the accounting and reporting committees of IAAC.

Task B was directed at work with commercial banks by selecting two banks to be designated as pilot banks. The work in the pilot banks included reviews of the accounting and management information systems with the objective to assist the banks toward complete conversion to IAS and the generation of management reports that will be more meaningful in the day-to-day operations of the banks. Policies and procedures were to be designed to institutionalize the changes within the accounting divisions of the commercial banks.

Experiences with the pilot banks are to be shared with the CBR and a larger group of commercial banks that agree to participate in the project.

After several revisions beginning in February, the work plan was finalized in April 2000 and accepted by USAID. Drafts of the work plan were delivered to the CBR in March. The CBR distributed it to the Human Resources and Prudential Supervision Departments for comments. We did not receive any further comments. The final work plan and the terms of reference were translated and delivered to the CBR in July.

Revision to the Work Plan

The original strategy of changing and converting the RAS to IAS was changed because of legal restrictions. The RAS are laws and regulations that are approved by the Ministry of Finance. RAS are also the basis for calculation of income taxes under the Tax Code. The IACC and the CBR do not have the legal right to unilaterally change the accounting of the commercial banks from RAS to IAS. The changes in the accounting laws must originate within the Ministry of Finance. It was determined that there was significant resistance within the Ministry of Finance to adopt IAS in total. Revisions of the RAS to IAS will be a gradual process that could take several years.

During discussions with the CBR in April 2000, the timing of the work plan was a major topic. There was a need to determine the transition timing and phasing of banks into the process of conversion. The CBR Chief Accountant requested more detail for a timeline and potential phasing of the conversion of commercial banks. A proposal was completed and presented for discussion after consultations with others involved in accounting reform in Russia.

In April and May 2000 this TA made a proposal to the CBR to develop guidelines and reporting formats that would be in compliance with IAS. The new guidelines and formats would then be used by the commercial banks for reporting to the CBR. The new guidelines and formats would also be based on a transformation from the RAS accounting data to IAS compliant financial statements. Adoption of IAS for daily transactions at the commercial banks was determined not to be possible until the RAS were revised and were comparable to IAS.

During meetings with representatives of the CBR in July 2000, the timing of the work with the pilot bank was delayed. The CBR was in the process of entering into another technical assistance agreement with Tacis to provide assistance in the conversion to IAS in the banking sector. Both the Tacis and USAID projects have similar work plans.

By the end of 2000, the selection of the pilot banks for both the Tacis and USAID projects was completed by the CBR. As part of the program for implementation of IAS compliant financial reporting to the CBR, new guidelines and instructions in the preparation of IAS compliant statements and reporting are to be developed. The delay by the CBR in the selection of the pilot banks and the timing to be used in the transition to IAS caused an

overall delay which slightly affected the completion of all of the work under the USAID project.

The timing for completion of this project was changed at the end of 2000. The delay afforded this TA the opportunity to alter the overall use of man-days and resulted in the ability to extend the completion date to mid-2000 at no additional cost to USAID.

There was general agreement that the implementation of IAS reporting would take significantly longer than the term of this existing USAID project. This TA agreed with the Tacis contractor to work jointly in the development of the new guidelines and instructions. The Tacis contractor also agreed to continue working with the two USAID pilot banks after the USAID project was completed in mid-2001.

Project Add-on

In the first quarter of 2000, the project was expanded to include additional funds to cover the cost of bringing several international finance and economic experts to Moscow. The experts had meetings with the CBR, MinFin and officials of the president-elect, Mr. Putin. They also lectured at Moscow State University, the Higher School of Economics and the Academy of Finance. The first group visited Moscow in April 2000.

During December 2000 the second group of experts came to Moscow. They made presentations during an economic conference and again met with various governmental officials.

In April 2001 one of the experts, Mr. Harberger, made a third visit to Moscow. He again met with governmental agencies and made additional presentations and lectures.

The presentations of the experts have been translated into Russian. A publication with the presentation papers is being prepared in Russian and English languages.

As part of the add-on for the economic portion of the project, a research project was conducted by the Expert Institute in conjunction with the Higher School of Economics. The study included research of the non-market sector in the Russian economy on the basis of economic efficiency. It will be the first example of applied research in the modern history of Russia.

With the additional time available on the project, USAID agreed to include a third pilot bank into the project. Another bank was chosen from the list previously presented by the CBR. The work was completed in July 2001.

Completion of the Work Plan

Task A – Technical Component

Support to the Inter-Agency Coordinating Committee (IACC) on Accounting Reform through the Reporting Committee, the Technical Accounting Group and the Training Committee.

An analysis of the existing accounting legislation and comparison of RAS to IAS was completed in the first month of the project. RAS are legally required for all businesses in Russia, including banks. It was obvious that the CBR had no authority to change the accounting standards from RAS to IAS. MinFin is solely responsible for changes to the RAS.

In April 2000 we proposed a strategy to develop guidelines and formats based on IAS that would be used by all commercial banks. In May 2000 we proposed to the Accounting Working Group of the IACC a transition timeline with details for the adoption of the newly developed instructional guidelines and formats. In each of these proposals, we suggested the IAS compliant guidelines and formats would be in addition to RAS. We also suggested the formation of an IAS unit within the CBR that was subsequently approved by the Board and implemented.

During the contract we reviewed and commented on several proposed CBR instructions to commercial banks. Most of the proposals were not in compliance with IAS and we responded with comments that would have made the instructions compliant with IAS. One of the instructions was structured to be compliant with IAS 7, Cash Flow Statement Preparation. It was adopted by the CBR board and sent to commercial banks during the first quarter of 2001. Approximately thirty proposed accounting instructions affecting IAS (specifically IAS 16, 17, 22, 27, 28, 30, 39, 39, and 40) were reviewed during the course of the project. None of the other instructions were implemented by the CBR.

During the contract we reviewed and responded to many specific accounting issues posed by the CBR. These issues included, but were not limited to, accounting for subsidiaries of the CBR, methodology for preparation of consolidated financial statements of the CBR, accounting for REPO transactions, accounting for foreign exchange gains and losses and forward contracts on hedges used in IMF lending activities, and accounting for dividends of a foreign-owned subsidiary of the CBR.

Since mid-2000 MinFin did make some changes to RAS for Earnings Per Share. The new accounting standard is essentially in compliance with IAS 33.

With the start of the new Tacis project, PricewaterhouseCoopers (PwC) is also working with the CBR on the development of new accounting guidelines and formats which are intended to be in total compliance with IAS. During meetings with PwC, discussed the limited time remaining on our project and decided PwC would take the lead in the development of the new guidelines and formats. While they were being developed, we

agreed we would comment on all drafts as they were released. These new guidelines and formats are in addition to the RAS currently required by law. PwC has dedicated specific consultants for the preparatory work. The work is expected to be completed in four parts. The first part has been released for comment to the pilot banks and the CBR.

After the comment period, the next step in the process will be the acceptance by the Accounting Working Group and the CBR Accounting Methodology Unit. The CBR board must approve the final document before it is released to the commercial banks.

It is our understanding PwC will have all four parts completed before the end of their project. We commented on the first draft prior to the end of this project.

If the complete set of guidelines, instructions and formats are completed by the end of 2001, the CBR should be able to complete its internal review process for approval of the documents by mid-2002. With the release of the new guidelines, instructions and formats by late 2002, all commercial banks will have one year to prepare for the January 1, 2004 deadline for IAS reporting which has been adopted by the CBR.

Task A –Training Component

All known materials on IAS were gathered for use in instruction at workshops and seminars held during the contract period.

During the term of the contract we conducted three separate workshops for CBR personnel in the accounting, supervision and general economic departments. Two of the participants in the first workshop are now training other personnel within the supervision department. These two participants have advised us they have trained more than 400 other personnel.

We also completed two workshops for personnel at ARCO. And we participated in regional workshops sponsored by FSVC. The regional CBR offices were well represented in these workshops. Two regional chief accountants and one head of supervision attended in Novosibirsk and Vladivostok. The workshops were also presented at the three pilot banks. More than 370 participants have attended IAS workshops during the tenure of the project. The details of the training are included in the attachments to this report.

Other training was conducted for specific IAS accounting issues. We also participated in discussions and lectures on IAS held by banking associations, the IMF at the Finance Academy, and Financial Analysts of Moscow.

Task B – Pilot Banks

The selection process initially used in conjunction with USAID was rejected by the CBR in June 2000. Final selection by the CBR of the pilot banks was completed in

December 2000. We were given a choice of four banks and selected two for our project. They were ProbusinessBank in Moscow and NBD Bank in Nizhniy Novgorod.

During the first quarter 2001 we completed all of the preliminary work at each of the two banks. An analysis of the accounting in each of the major core areas plus internal control was completed during on-site visits. We also examined the internal methodology used in the transformation of the RAS data to IAS compliant financial statements.

Management reporting was also reviewed during the on-site visits. As mentioned above, training in IAS was conducted in each of the banks. The financial statements of the pilot banks were used during the IAS workshops. Case study materials were gathered for use in training of other commercial banks.

In the second quarter of 2001 we requested approval from USAID to add a third bank to our project. USAID agreed and we added Center-invest of Rostov-on-Don that was one of the four banks on the original list from the CBR. We visited the bank in July 2001 and completed the same work in the core areas, internal control and management reporting.

Each of the three banks has the capability to complete the transformation from RAS to IAS without the assistance of their external auditors. NBD Bank has developed an excellent transformation methodology that we recommended they sell or make available to other commercial banks. When the new guidelines, instructions and formats are released from the CBR, these banks will be in a position to respond very quickly.

Coordination with Other Projects and Technical Assistance Donors

To avoid duplication of effort and to encourage synergy and cooperation, there was significant contact with accounting reform projects and other projects related in some way to this project. The following is a summary of the activities with the various firms and agencies.

1. PricewaterhouseCoopers (Taxis) – there were many meetings to share information developed before the beginning and during the Taxis project. Accounting issues were discussed and training materials were shared.
2. Financial Services Volunteer Corps (FSVC) – the resident advisor presented during four IAS workshops organized by FSVC in Samara, Novosibirsk, Omsk, and Vladivostok. The resident advisor was the sole presenter at Vladivostok. The resident advisor also participated in consultations with the CBR regional offices and commercial banks in each region. Other meetings were held to discuss specific accounting issues, bank payment systems and the selection of pilot banks.
3. Agency for Restructuring of Credit Organizations (ARCO) – two IAS workshops were presented to accounting specialists from several departments. Meetings were held to discuss specific accounting issues and the selection of the pilot banks. IAS materials were provided to assist in the development of the Agency reports.
4. KPMG (Taxis) – meetings were held to discuss their work on accounting reform with MinFin and the method they are using to implement the adoption of IAS in place of RAS.
5. International Center for Accounting Reform (ICAR) – several meetings to discuss our project progress, tie-in related work on new accounting laws and drafts of instructions, and participation with ICAR in other forums on accounting reform. The ICAR Russian translation of the IAS Practical Guide was used as the primary text for the IAS workshops.
6. Foundation for International Accounting in Russia (FIAR) – coordination of the banking reform and enterprise reform projects through participation in seminars and meetings with various RF government officials.
7. IMF and Ministry of Finance – presentation of two lectures to personnel from MinFin and regional governments on IAS for banks and the linkage to the Treasury.
8. IMF – many meetings with local and Washington-based personnel and consultants to discuss the status and progress of the bank accounting reform.
9. Software firms – meetings with the three largest bank software firms in the country (FORS, R-style, and Diasoft) to discuss requirements for the development and implementation of software modules for IAS. The development of a payment system was discussed with the head of IBM – Russia.

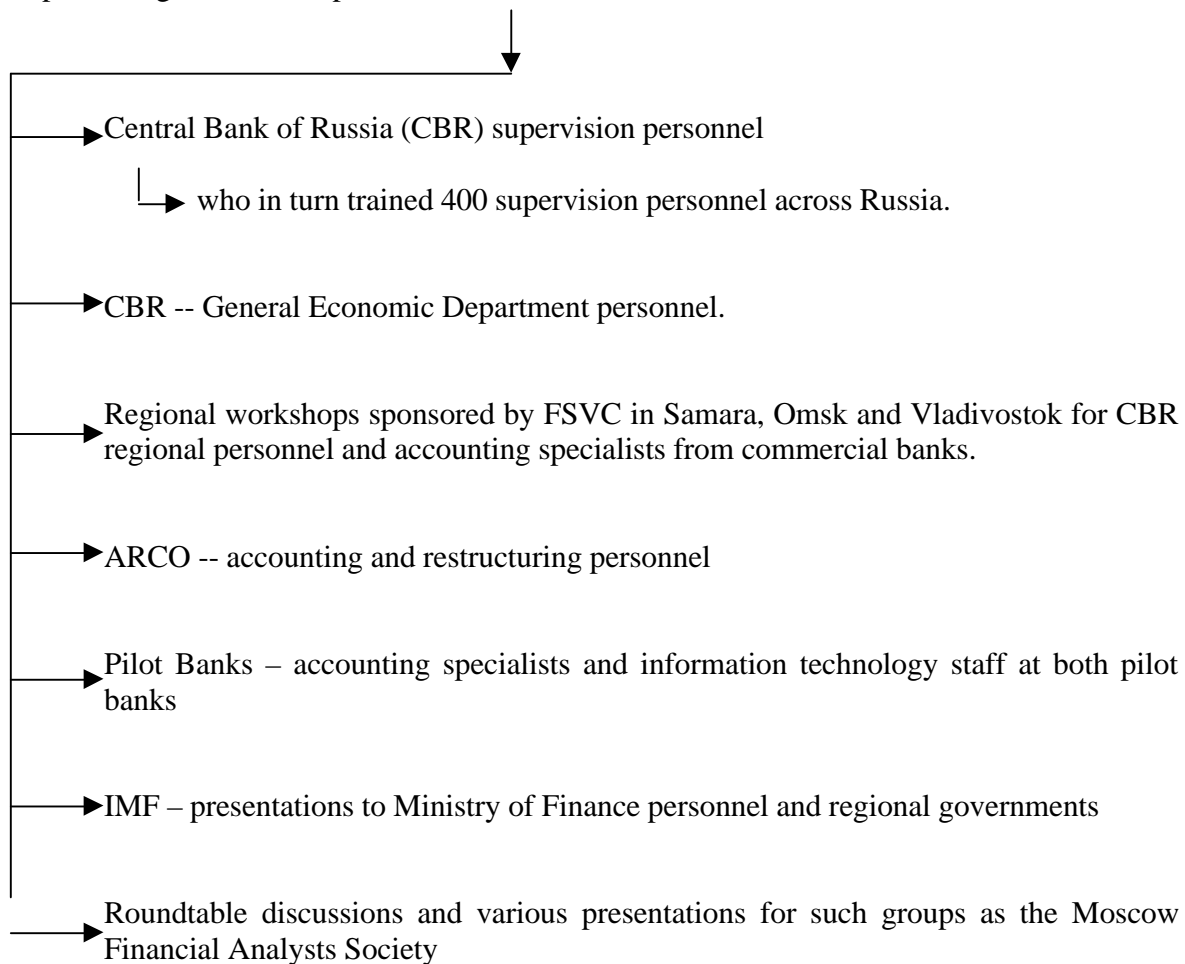
10. World Bank – many meetings with local and Washington-based personnel to discuss the status of the bank accounting reform, CBR consolidated financial statements, selection of pilot banks and other accounting issues in commercial banks.
11. Financial Analyst Society of Moscow – presentation of lecture to members of the group on IAS as it relates to bank accounting reform.
12. Financial Institutions Development Project (FIDP) – Bank Review Unit – meetings to discuss the progress of bank accounting reform and the selection of pilot banks.
13. Ministry of Economy and Trade – Accounting Methodology Unit – meetings to discuss the conversion to IAS and the transitional timelines needed to achieve the conversion.
14. US-Russia Investment Fund and Delta Credit – meetings to discuss the accounting reform project, the mortgage program offered, and their progress and programs with participating banks in Russia.
15. International Finance Corporation – meetings to discuss the progress of bank accounting reform and specific issues relating to their involvement in the pilot banks. Also meetings to discuss the leasing program offered by IFC in Russia.
16. European Bank for Reconstruction and Development (EBRD) – meetings to discuss the bank accounting reform and specific issues relating to their investment as shareholder in one pilot bank and involvement with other banks in Russia.
17. ACDI/VOCA – meetings to discuss the progress of bank accounting reform and sharing of informational materials.
18. Canadian Embassy Technical Assistance Program – meetings to discuss the progress of the bank accounting reform project and other technical assistance projects at the CBR and commercial banks.
19. Department for International Development (British KnowHow Fund) – meetings and discussions concerning the technical assistance programs for the CBR and commercial banks offered by them.
20. Carana Corp – meetings to discuss the progress of bank accounting reform and the relationship with the enterprise programs. Used the IAS transformation kit as part of the IAS workshop.
21. Various meetings with bank officials and others concerning bank accounting reform and the transition to IAS. These meetings included ABN-AMRO Bank, Ak Bars Bank, American Chamber of Commerce in Russia, Arthur Andersen, Kommersant newspaper, Vedomosti newspaper, BIN Bank, Citibank, Sobinbank, American Institute of Business and Economics, Global Association of Risk Professionals – Russia Chapter, Thomson Financial, Raiffeisen Bank, Troika Dialog, and Vozrozhdeniye Bank.

In addition to the local coordination, there was additional involvement in accounting issues and developments in Kyrgyzstan, Kazakhstan, Uzbekistan, Bulgaria, Mongolia, and Armenia. There were discussions on specific accounting issues and training for commercial bankers. There was some coordination of activities with other USAID projects with an Armenian businessman who had banking interests in Moscow.

KNOWLEDGE TRANSFER

A workshop on International Accounting Standards (IAS) was the primary vehicle for knowledge transfer. The workshop delineated the differences between IAS and RAS (Russian Accounting Standards).

The initial presentation to the Inter-Agency Coordinating Committee served to develop and refine the format of the workshop, questions and additional materials. This led to presenting the workshop for different audiences.



Training Completed

Date	Description	Location	# Sessions	#Participants	#Hours
<u>2000</u>					
4/10 - 4/11	IAS Workshop (FSVC)	Samara	2	75	16
5/29	Roundtable IAS Discussion	Bankers' Assoc St. Petersburg	1	30	5
7/18 - 7/31	IAS Workshop for Acctg Working Group	CBR Moscow	10	28 (plus Ms. Gudenko)	19
7/26	Consolidated Accounting for Associates	CBR Moscow	1	2	2
8/2	FX treatment of Forward Contracts	CBR Moscow	1	8	3
8/10	Cash Flow Statement Preparation	CBR Moscow	3	2	3
9/22	IMF lecture for MinFin on "IAS and banking"	Finance Academy Moscow	1	40	2
9/25 -	IAS Workshop	CBR Accounting and Supervision, Moscow	10	14	19
10/10 - 10/11	IAS Workshop (FSVC)	Novosibirsk	2	60	15
10/12- 10/13	IAS Workshop (FSVC)	Omsk	2	22	15
10/16- 10/27	IAS Workshop	CBR General Economic Dept., Moscow (28 on list)	10	25	19
10/16- 11/19	IAS Workshop	ARCO Moscow (27 on list - 20 certificates)	11	25	21

12/6	Lecture on Status of IAS in banking	Financial Analyst's of Moscow	1	18	2
12/13-	IAS Workshop	ARCO Moscow (19 on list)	9	15	18
<u>2001</u>					
1/16 -	IAS Workshop	Probusiness Bank Moscow (pilot bank) (21 on list)	11	16	19
1/17 -	Consolidated Statements for CBR	CBR Moscow	3	3	6
2/19- 2/23	IAS Workshop (FSVC)	CBR Vladivostok	5	66	15
3/5 - 3/19	IAS Workshop	NBD Bank (pilot bank) Nizhny Novgorod	8	14	14.5
5/28	IMF Lecture for MinFin on "IAS and Banking"	Finance Academy Moscow	1	31	3
7/14	IAS Workshop	Center-invest (pilot bank) Rostov-on-Don	6	13	14
Summary:			Number	Participants	
IAS Workshops organized by project			8	159	
IAS Workshops organized by FSVC			4	223	
Total in IAS workshops				373	
Roundtable lectures and accounting issues			8	134	

Success of the Project

The project was successful in many areas.

A transitional timeline was presented in May 2000. Almost a year later the timeline was presented by the CBR and GRF as part of the mid-term economic plan for 2001 and beyond. The CBR will be requiring IAS compliance financial statements from commercial banks by January 1, 2004.

There was adoption of some new guidelines and formats for IAS compliant issues. Many reviews and comments were made. One major adoption was the Cash Flow Statement Preparation instructions and format that is structured to be in compliance with IAS 7. It was released to the commercial banks in January 2001. New instructions that were not in compliance with IAS have not been released to the commercial banks.

During the term of the project there was a major change in the attitude at the CBR to accept IAS. It took several months to gain their confidence. The IAS training to the Accounting Working Group and the CBR accounting methodology unit contributed to a better understanding of IAS. After acceptance, the CBR began using the resident advisor to discuss specific accounting issues. An example is the discussions in establishing the methodology to be used the CBR in the preparation of its consolidated IAS financial statements

The training conducted under the project has been very successful. There were twelve IAS workshops plus many lectures and presentations on IAS and specific accounting issues related to the CBR and the commercial banks. During the workshops, there were 373 participants. CBR trainers reached another 400 bank supervision personnel.

DAI facilitated three visits of international experts to advise the Russian Government transition team and governmental economists on subjects including pension reform, budgetary management and tax policy. These visits were funded by expansion of the task order by USAID. As a result of this activity, the USAID/Russia Office of Economic Policy Reform received a US Department of State award for “extraordinary success in facilitating dialog between international economic experts and Russian policymakers and in thus enhancing the role of the United States in supporting Russia’s economic transition.”

Description of the Tangible Results and Benchmarks Met

The original contract between USAID and the contractor did not have specific tangible results and benchmarks against which the performance under the contract could be measured. The contract does have a Statement of Work on pages 5 to 9. The Statement of Work was the basis for the preparation of the Work Plan that has been presented above. Another section above, "Completion of the Work Plan," gives details of the activities during the term of the project.

Each item and paragraph in the Statement of Work has been accomplished and in some instances the completed work exceeded the expectations of the contract.

Task A – Technical Support:

We supported the Reporting and Technical Accounting Committees to the extent we were invited and/or allowed to attend the meetings. There were very few committee meetings during the term of the contract. We realized that we could not achieve our goals if we waited for the committee heads to schedule meetings. We, therefore, scheduled our meetings with the representatives of the various departments of the CBR and the IMF/World Bank mission representatives responsible for each of the working groups.

Working with the Accounting Working Group, we developed the IAS workshop based on input from various members of the group, including the CBR Chief Accountant, Deputy Chief Accountant, Head of the Accounting Methodology Unit, and other unit leaders. This input also came during the first presentation of the training at the CBR.

We reviewed more than 4,000 pages of CBR instructions and guidelines, existing accounting legislation and regulation, and effects of the Tax Code on the banking sector. We also completed an analysis of the business environment of the banking sector. As a result of these reviews and based on the fact that there are legal restrictions imposed on the ability of the CBR to implement new accounting standards, we prepared a proposed strategy to develop guidelines and formats based on IAS that could be used by the commercial banks. We also prepared and presented a transition timeline with details for the adoption of proposed new guidelines and formats. In these proposals, we constantly stressed the guidelines and proposals for IAS reporting would be in addition to the required RAS. We also suggested the formation of an IAS unit within the CBR that was subsequently approved by the CBR board and is being implemented.

The proposals were more aggressive than the timeline and transition period agreed by the CBR. However, because of the legal restrictions encountered and disagreements among three departments of the CBR on the new reporting formats, no new reporting format was implemented for the year ended December 31, 1999. In fact, the resident advisor under this contract did not start work at the CBR until March 1, 2000.

We reviewed the existing set of CBR reports currently required for submission by the commercial banks. The Supervision Department wanted to make changes to the reports but did not wish to begin the changes until the new set of IAS guidelines and instructions were prepared. There was also a disagreement among various departments of the CBR on the content of the reports. And a conflict between IAS data and the data required for collection by the IMF. A logistical issue also arose when the CBR realized that the supervision and accounting personnel of the CBR did not have the proper conceptual knowledge of IAS to understand and react to reports based on IAS if the commercial banks did submit reports based on IAS. The new guidelines, instructions and formats currently being prepared under the Tacis project will be the basis for commercial banks to report to the CBR. Training in IAS has been conducted since the summer of 2000, both by this project and by members of the supervision department.

The CBR was involved in the selection process of the pilot banks. The CBR will need to review and approve the new guidelines, instructions and formats for reporting of the commercial banks based on IAS compliant data. The guidelines, instructions and formats are being developed and are expected to be completed under the Tacis project.

The coordination with other experts, donors and projects is outlined in another section of this report. We were very active in sharing information among the various donors and projects. We were also very active in discussions on the progress of the bank accounting reform with mission representatives of IMF and World Bank. There were also occasions when we were outspoken and in disagreement with the direction of other accounting reform projects that had a negative effect on the work we were trying to accomplish.

We commented on many proposed accounting instructions and specific problems posed by the CBR. The resident advisor spent a significant amount of time addressing technical and methodological situations relating to many IAS. Some of the recommendations and comments were adopted. We recommended the CBR not adopt nor implement any proposal not in compliance with IAS.

Task A – Training Component

We prepared an IAS workshop to present the differences between RAS and IAS. All known materials were gathered for use in the development of the workshop. This workshop was presented twelve times during the term of the project. The workshop concentrated on the differences of RAS and IAS plus the proper application of IAS within the banking sector. Case studies were used to discuss specific accounting and methodological issues. Textbooks were distributed as part of the instruction. The reports to the CBR were not used because the final guidelines, instructions and formats are not complete. The material presented also focused on the legal restrictions placed on businesses to use RAS and the methodology necessary to transform the RAS data to IAS compliant statements.

The training was initially presented to the Accounting Working Group members within the CBR, including the Chief Accountant and some of her deputies. Three training workshops eventually reached 67 participants in the accounting, supervision and general economic departments of the CBR. Two of the supervision department participants from the initial CBR group began training others within the supervision department. They have advised us they have trained more than 400 personnel in the supervision department.

The training materials were made available to many others outside the CBR. The newly-formed Bank Unit within the Ministry of Taxation has received the training materials. Personnel at the Finance Academy and the Ministry of Finance from Moscow and various regions have also received the materials. We also provided the materials to members of the Accounting Methodology Unit of the Ministry of Economy.

Two of the IAS workshops were presented for forty accounting specialists at ARCO. These presentations were outside the scope of work of the project and were presented during the evening and weekends. We also presented the training to 223 participants during regional workshops organized by FSVC under another USAID project. There were four of the regional workshops in Samara, Novosibirsk, Omsk, and Vladivostok. Since the presentation was outside the scope of work of the project, vacation time was taken to make the presentation in Vladivostok. The Chief Accountants of at least two of the regions and the head of supervision for one region were participants in the workshops.

The World Bank published “A Practical Guide to International Accounting Standards.” It was translated into Russian in 1999. The book was out of print and not available. Another accounting reform project re-translated it into Russian and had it published. We purchased and distributed 1,000 copies of the text for our IAS workshops. The text is the best available text for practical application that exists at this time. We also provided several hundred copies to the new IAS unit being set up at the CBR. Since it was limited to the first 38 standards, we wrote and translated training material for IAS 39 and IAS 40. The Tacis project is active in presentations at the local universities in Moscow. We did not attempt to duplicate the work they are doing with the universities.

Task B – Pilot Banks

Initially we worked with USAID and six other agencies/donors to select the pilot banks for this project. By June 2000 we had completed our selection and submitted the list to the CBR for approval. At that time, the CBR was in the process of completing the negotiations with Tacis for additional technical assistance that also included six pilot banks. The CBR rejected the process used by our project and elected to use another criteria for selection. The banks on our list appeared on the list of the CBR when it became available in December 2000. We were given a list of four banks from which we chose the first two for our project. Those two banks were ProbusinessBank in Moscow and NBD Bank in Nizhniy Novgorod.

The review of the pilot banks included an analysis of the accounting function in the banks and an analysis of the internal controls, accounting transactions in the primary core areas of operations, and a review of the management reporting. We also reviewed the existing accounting policies and procedures with the aim of streamlining the manner in which transactions are treated within the accounting departments of the banks. In addition, the methodology used in the transformation of RAS data to IAS compliant statements was reviewed. The MIS were reviewed to determine the changes needed to convert to IAS transaction basis accounting within the constraints of the existing legislation.

By mid-2001 we realized we had sufficient time to add a third bank to our project. We requested and received USAID approval. The third bank was Center-invest of Rostov-on-Don. We visited the bank in July 2001 and completed the same review as was conducted at the first two banks.

Training was conducted at each of the three banks. The IAS workshop was the primary training tool and was presented during weekends and evenings during the review of the three banks. As the training was presented in each bank, we used that bank's financial statements as the basis for case studies, comparisons, and application of the IAS. Some additional case study material was accumulated for distribution and use in other training at the next group of banks selected for participation in training and pilot bank work.

The reports generated during the review process were shared with the banks. Recommendations were made for improvements in the accounting and reporting, internal controls and management reporting. We also performed extra analysis work with ProbusinessBank on certain procedures.

At each bank, they are transforming the existing RAS data to IAS compliant financial statements. The Ministry of Finance has not adopted IAS as the accounting standards for Russia. Until it does adopt IAS, the RAS must continue to be used and a transformation will be necessary. Each of the three pilot banks have the capability to internally generate IAS compliant statements without the assistance of the external auditors. One bank has developed an exceptional automated model and we have recommended it share the model with other banks. These three pilot banks will be ready to implement the new guidelines, instructions and formats when released by the CBR.

Recommendations to USAID

We are attempting to achieve transparency in the financial sector. Sharing information with the counterparts is one of the most important facets of this transparency. Copies of the Terms of Reference should be translated and shared as early as possible. The Contract objectives and tangible results should be translated and shared with the counterpart/beneficiary. The Work Plan should be submitted in draft form with a request for comments. When the Work Plan is finalized, the translated copy should be made available with all members of the counterpart team.

USAID is currently considering a project on bank supervision. When the Tacis project is complete, there should be a new set of guidelines and instructions with formats. This information is the basis from which the bank supervision project could begin to build the necessary components for the actual reporting by the commercial banks. The information available will be compliant with IAS and will need to be structured for the use of the supervision project. The timing of the start of the supervision project should coincide with the final set of guidelines, instructions and formats. The formats may need to be changed to fit the reporting requirements of the CBR supervision departments.

The CBR has authorized an IAS unit within the CBR. One lady has been given the responsibility for the unit but is also working on other projects within the accounting department. We provided some training materials for continuing use by the unit. It is not yet staffed because the CBR has a policy that outlines the salaries to be paid to the staff of the CBR. Personnel with IAS experience will tend to work at places where the salaries are more attractive. There will also be a tendency for the IAS unit personnel to leave the bank once they are trained – again because salaries are more attractive outside the CBR. It may be possible to put together some kind of funding from a donor agency to subsidize this unit during its formative years until IAS is used in the CBR and by the commercial banks.

Training in IAS has been relatively limited. There are estimates of about 20,000 personnel in the accounting and supervision departments of the CBR who will ultimately need to be trained in IAS. Some training has been started within the supervision department. In addition, there are more than 10,000 accountants in the commercial banks that should be trained. Plus there are thousands of accountants working for external audit firms that need the IAS training. There should be a concentrated effort on the part of the donor agencies to organize training.

Changes and additions to the curriculum of the universities should also be reviewed and requests made to include IAS training. The current group of students matriculating could have current training. By the time new students complete four years, all accounting graduates would have been exposed to IAS. For the banking sector, the expansion of IAS knowledge in the country would have been covered

There is also a need for more training in corporate governance, risk management and financial management of senior managers, line managers, branch managers and internal auditors within the commercial banks. Some of this training would also be good for supervision personnel at the CBR.

Attachments

Accounting Issues with the Central Bank of Russia

The Number of International Accounting Standards

Pilot Bank Reports

- Recommendation Letters

- Letters to CBR and USAID

- Extra analysis for ProbusinessBank

Training Materials

- Agenda

- SWAP Example

- Cash Flow Statement Preparation

- IAS #39 Training material

- IAS Final Examination

Checklists for Seminar Preparation and Presentation

Scope of Work for Research Project – Yassin

Lessons Learned

Presentation to USAID – August 8, 2001 (Power Point)

Accounting Issues with the Central Bank of Russia

The following is representative of the major topics discussed with accounting specialists of the CBR during the term of the project.

<u>Date</u>	<u>Issue/Subject</u>	<u>Comment</u>
<u>2000</u>		
May 15	Proposed Federal Law on Accounting	Review and comment of response from Paramonova to MinFin
May 17	Securities Repurchase	Review and comment on CBR instruction on accounting for purchase of securities with agreement to redeem. (REPO) IAS response based on IAS 39.
Aug 2	Foreign exchange accounting for IMF loan with forward contracts hedging exposure of two of four currencies.	Significant discussions were held regarding accounting for the hedge, accrued interest payable, and the gains and losses from the transactions.
Aug 4	Stock dividends of foreign Subsidiary of CBR	Several scenarios were presented and commented on for IAS compliance.
Aug 7	Instructions for Cash Flow statement preparation	Draft of instructions was reviewed and comments provided. Two additional meetings to discuss the format and implementation.
Aug 18	Proposed instructions on fixed asset accounting	A review of a major document (56 pages) was requested to determine compliance with IAS. Prepared and delivered memo with comments on the proposed instructions.

2001

Jan 17	Preparation of IAS Consolidated Statements	First discussion with CBR on the methodology for transformation and preparation of consolidated financial statements for CBR and its subsidiaries.
Jan 18 - 22	Research for IAS Consolidated Statements	Research and discussions with IMF/World Bank concerning the preparation of IAS consolidated statements for CBR, SberBank, and other subsidiaries of the CBR.
Feb 1	Forward contracts	Discussions on the accounting for Forward contracts, interest on forward contracts, and valuation of accounts for on- and off-balance sheet presentation.

The Number of International Accounting Standards

There most current standard to take effect is IAS # 40. With replacements there are no longer forty different standards.

The following standards no longer exist:

- IAS #3 – replaced by #27
- IAS #4 – replaced by #16 and #38
- IAS #5 – replaced by a revision to #1
- IAS #6 – replaced by #15
- IAS #9 – replaced by #38
- IAS #13 – replaced by a revision to #1
- IAS #25 – replaced by #40

Because the above seven no longer exist, the number of actual standards currently in effect is reduced by seven to 33.

Some of the remaining standards do not apply to banks.

- IAS #2 – Inventories (banks simply don't have inventories)
- IAS #11 – Construction Contracts (banks are not in the business of constructing buildings for others).
- IAS #15 – Information Reflecting the Effects of Changing Prices (the standard is not required and has little, if any, effect on banks).
- IAS #19 – Employee Benefits (has a very small effect on banks).
- IAS #20 – Accounting for Government Grants and Disclosure of Government Assistance (there is little or no effect on commercial banks).
- IAS #26 – Accounting and Reporting of Retirement Benefit Plans (few, if any, banks have separate retirement plans in Russia).

Five of the six above have little or no effect on commercial banks. IAS #19 may still apply and is not eliminated.

Based on the above information there are only 28 standards that apply and have any significant effect on commercial banks in Russia.

Recommendation letters for Pilot Banks

In this section are the letters sent to each bank as a result of the on-site visits with each of the three banks. The letters were prepared in draft format and delivered for comment to each bank. After comments were received by the banks we prepared and delivered the final recommendation letter.

The final recommendation letter for each bank was also forwarded to the CBR and USAID.

The letters are presented in this attachment without the backup detail which involves other software such as Visio, Draw, and Excel. The formats are not compatible and the detail is not included.

Inter-Agency Coordinating Committee
Chaired by the Central Bank of the Russian Federation
Accounting Working Group

Bank of Russia, 12 Neglinnaya Street, Entrance A, Suite 333, Moscow, 103016 Russian Federation
Telephone/FAX: (095) 929-4873; e-mail: dai-mocow@www.cbr.ru

24 March 2001

Mr. Eldar Bikmaev, Deputy Chairman
ProbusinessBank
15 Petrovka Street
103031 Moscow
Russian Federation

Dear Mr. Bikmaev:

It has been our pleasure to work with you and your staff over the past weeks. I would like to thank you and them for their cooperation, courtesy and assistance. Their attendance at and participation in our International Accounting Standards training has been commendable.

During our review of ProbusinessBank's accounting functions, we concentrated on the five primary operating areas of the bank,

1. loans,
2. deposits,
3. securities,
4. fixed assets and
5. foreign exchange.

These are either core businesses of the bank, or they generate significant volumes of accounting entries. In the course of the review, we also examined internal controls for efficacy. The individual analysis of these areas is attached.

It is our opinion that ProbusinessBank is capable of generating accurate and timely financial statements, which comply with International Accounting Standards, and that there is now enough knowledge of International Accounting Standards in the bank to select a general ledger processing system that will generate those statements automatically. We understand that at this point in time, this effort requires a manual transformation from Russian Accounting Standards to International Accounting Standards.

We would offer the following recommendations:

I. Increase Productivity

- I.A. Replace internal controls layered onto existing processes with controls built into revised processes.

Layering on controls after the fact, for example, extra approval signatures or another check of work performed, consumes more time and resources than building the controls into the process as it is designed.

Analyzing processes by breaking them down into their component tasks and eliminating or replacing steps or controls that do not add value for the client or the bank or provide appropriate levels of control for the risk involved increases productivity and improves client service by speeding up processing.

- I.A.1. Review and modify existing expense limits for managers for expense and capital purchases on an annual basis.
- I.A.2. Reduce the number of signatures in the purchase approval process, including eliminating the president's.
- I.A.3. Recognize that the budgeting process is an effective control, and use it to replace other redundant controls.
- I.A.4. Reduce the number of times the same people handle the loan package.

- I.B. Reduce follow-up control, re-doing work multiple times to ensure accuracy, to the minimum the Central Bank of Russia will tolerate.

- I.B.1. Assess the risk involved in a task or step in a process and replace re-doing the work with a control appropriate to the risk involved. Examples are:
 - ❖ Use zero-sum balancing more often to control, rather than a second person doing the same work.
 - ❖ Eliminate follow-up control where the significance of a possible error does not warrant it.
- I.B.2. Expand internal auditors' role. (This is discussed in detail in the analysis of internal controls document attached.)
- I.B.3. Find ways to deliver more clients' statements. Suggest on the statements that the client reconcile them with his records.

- I.C. Replace the current RS Banker software with a system that will accommodate budgeting by cost/profit center and has integrated modules for all of the bank's products and services. This would reduce the bank's reliance on Excel spreadsheets and Lotus Notes as substitutes for software designed for specific purposes, e.g., securities trading and securities inventory tracking. A system with integrated

modules would also reduce the risk of unauthorized activities and increase productivity by eliminating programming and clerical work.

ProbusinessBank has very successfully used Excel and Lotus Notes to fill in where RS Bank does not have modules and/or where the bank's requirements are more stringent than the CBR's and/or RAS, which are the requirements R Systems chooses to meet. However, these programs are not designed to provide the level of security bank transactions require. Although ProbusinessBank's manual controls over the information moved through Lotus Notes and Excel is very good, there is the risk of unauthorized entries and hacker activity.

II. Reduce the Need for Staff

II.A. Impose a hiring freeze.

II.A.1. The Managing Board declares that no additional staff will be hired and no layoffs will be made. As a position becomes "open," through retirement, the incumbent leaving for another bank, etc., the manager of that unit must justify to the Managing Board

- ❖ either filling that open position as defined or
- ❖ filling a newly defined position which better suits the changing needs of the work unit.

II.B. As volumes increase, do not add staff.

Make managers responsible for finding ways to respond to the increase in workload with the existing staff. For example, removing unnecessary controls will free staff familiar with the work and ProbusinessBank's policies to take on new tasks or jobs.

III. Improve Client Sales and Service

III.A. Make the bank's physical image more welcoming, friendly, and easy to approach. ProbusinessBank's advertising on billboards and brochures shows a friendly hand reaching out to the client. Change the physical appearance of the bank to be consistent with the advertising.

III.A.1. Post as nice a sign on the entrance to the bank headquarters for business clients as there is for the entrance for individual clients.

III.A.2. Open up the business clients' entrance to the headquarters building. Replace the closed booth with its glass barrier and the guard's unfriendly greeting with an open counter and a friendly face. Move the signage that directs clients to the appropriate office to a more conspicuous wall. Eliminate the second guard

checking for passes. Have the first guard allow people past him after they obtain a pass from him.

This consultant witnessed potential clients starting up the steps to the offices where business clients are served, only to be turned back by a frowning security guard telling them to obtain a pass down the stairs and around the corner.

- III.B. Establish and measure standards of client service.
Western banks are increasingly measuring performance against more than financial indices. Examples of these measure are:
- ❖ speed of service, such as how long does it take a client to make a deposit into an existing account.
 - ❖ accuracy of service, how many mistakes are made in clients' statements and how quickly are they corrected.

- III.C. Survey clients and non-clients and respond to their comments and suggestions.

III.C.1. Have the staff that opens new accounts and/or closes accounts ask the client why they are opening/closing an account and forward that information to the marketing department for collection and analysis.

III.C.2. Design a small client service survey form and make it available to clients all over the bank. Have the return address the marketing department where the data is analyzed.

- III.D. Add new products and services such as
- ❖ ordinary drafts drawn on a correspondent in FX and
 - ❖ locating a notary in the same building as the bank.

IV. Improve Management Reporting

IV.A. ProbusinessBank produces financial reports according to both RAS and IAS. The reports are accurate and contain all the necessary data. However, the reports could be pared down to essential information, redesigned to increase their readability, distributed further down in the organization, and, in some cases, produced more often.

IV.A.1. Start with a user definition of desired reports. Define the data to be included, how detailed the data should be, to whom the report should be distributed and how often. Once these decisions are made, the reports can be designed in a standard format with identifying numbers.

IV.B. When ProbusinessBank begins to measure non-financial service quality, management reports will have to be designed for these measures.

V. Strategic Planning

V.A. Probusiness Bank lacks a strategic plan. There is neither a Vision Statement nor a Mission Statement on view in client areas and internal departments of the bank. The bank needs a plan complete with Strategic Objectives and Strategic Tasks that every employee is aware of. In order to decide which data processing system is the right one, to design management reports that reflect the measures that bank management needs, and to compensate employees for results that advance the banks goals, employees need to know what those goals are.

Best regards,

Phillip W. Smith
Resident Advisor

Inter-Agency Coordinating Committee
Chaired by the Central Bank of the Russian Federation
Accounting Working Group

Bank of Russia, 12 Neglinnaya Street, Entrance A, Suite 333, Moscow, 103016 Russian Federation
Telephone/FAX: (095) 929-4873; e-mail: dai-mocow@www.cbr.ru

28 March 2001

Mr. Andrei Betin,
NBD Bank
Place Gorkogo 6
603600 Nizhny Novgorod
Russian Federation

Dear Mr. Betin:

It has been our pleasure to work with you and your staff over the past weeks. I would like to thank you and them for their cooperation, courtesy and assistance. Their attendance at and participation in our International Accounting Standards training was outstanding.

During our review of NBD Bank's accounting functions, we concentrated on the five primary operating areas of the bank,

6. loans,
7. deposits,
8. securities,
9. fixed assets and
10. foreign exchange.

These are either core businesses of the bank, or they generate significant volumes of accounting entries. In the course of the review, we also examined internal controls for efficacy. The individual analysis of these areas is attached.

It is our opinion that NBD Bank is generating accurate quarterly financial statements that comply with International Accounting Standards (IAS) and could increase the frequency to monthly without problems. There is now enough knowledge of IAS in the bank to support the Bank's eventual transition to IAS. We understand that at this time preparing IAS statements requires a transformation from Russian Accounting Standards.

NBD Bank has wisely profited from previous consultants' knowledge and recommendations. Your organizational structure is market oriented. You have a good strategic plan that gives the Bank a sense of sure direction. And, your financial reports are excellent.

There are two possibilities for case studies to be used in further training of other banks:

1. the Bank's use of an Excel program to produce IAS statements and
2. the Bank's financial statements for financial statement analysis.

We would offer the following recommendations:

Lending –

Appraisals

NBD does not currently charge clients for appraisal services. By charging clients for appraisals and by selling appraisal services to non-clients, the Bank could increase non-interest revenue.

The appraisal staff reports to the credit department where loans are originated. By separating the appraisal function to another department, appropriate internal control would be established without increasing costs.

Institute an incentive program for appraisers with loan losses deducted from a pool funded with the appraisal fees.

Loan Fees

Charge loan fees to clients when loans are made.

Create a commission program funded by loan fees to encourage the continuation of good quality loan origination. Subtract loan losses from the commission pool.

Implementation of incentive programs like the above would help the Bank be more competitive in the local labor market.

Fixed Assets –

Eliminate the redundant double entry of data into both the Convey fixed asset system and into an Excel spreadsheet. Program the Convey system to enable it to export a file to Excel if and when the ability to model or print the numbers is desired. Discontinue using the Excel spreadsheet on a daily basis. All the information necessary to manage the Bank's fixed assets is entered into Convey.

Non-earning assets are a relatively large portion of the Bank's assets. It could be worth the Bank's time and effort to consider a sale-lease back arrangement for the buildings it owns. The result could be an increase in earnings by using the cash to generate new earning assets.

Internal Controls –

Expand the internal auditors' role. (This is discussed in detail in the analysis of internal controls document attached.)

We are very pleased that NBD Bank is sending internal control staff to the PricewaterhouseCoopers audit training in Moscow over the next few months.

Reduce follow-up control by eliminating redundant double-checking. Only perform necessary activities to the minimum the Central Bank of Russia will tolerate. Replace re-doing the work with a control appropriate to the risk inherent in the task.

Accounting under IAS –

Continue to take advantage of any training available to increase the breadth of IAS knowledge available to the Bank.

Management Information Reports –

The Bank has developed a very clean, logical Excel spreadsheet program to convert RAS financial information to financial statements that conform to IAS. It has the potential to be marketed to other banks. We would suggest exploring that possibility to increase non-interest income.

As the Bank moves into measuring areas other than financial performance, e.g., service quality, include designing and producing management information reports for these measurements.

Strategic Planning –

Update the strategic plan with new scenarios. The existing plan is now outdated because the scenarios were dependent upon the actions of EBRD. The actions are now known. New scenarios can now be constructed with more certainty. Examples would be

- ❖ what might happen if the Bank's large paper mill client has problems and cannot repay its loan?
- ❖ what might happen if the Russian government rescinds the requirement to convert 75% of export proceeds to roubles?

Thank you again for the opportunity to work with you and your staff. The efforts of the bank to work with IAS will be of greater importance as the bank continues to prosper. We wish you and your bank every success in your work.

Best regards,

Phillip W. Smith
Resident Advisor

Inter-Agency Coordinating Committee

Chaired by the Central Bank of the Russian Federation

Accounting Working Group

Bank of Russia, 12 Neglinnaya Street, Entrance A, Suite 333, Moscow, 103016 Russian Federation

Telephone/FAX: (095) 929-4873; e-mail: dai-mocow@www.cbr.ru

20 July 2001

Mr. Vasily Vysokov, Vice President
Bank Center-invest
62 Sokolova Avenue
Rostov-on-Don 344010
Russian Federation

Dear Mr. Vysokov:

It has been our pleasure to work with you and your staff during our visit to Center-invest. I would like to thank you and them for their cooperation, courtesy and assistance. Their attendance at and participation in our International Accounting Standards discussions has been commendable.

During our review of Center-invest's accounting functions, we concentrated on the five primary operating areas of the bank,

11. loans,
12. deposits,
13. securities,
14. fixed assets and
15. foreign exchange.

These are either core businesses of the bank, or they generate significant volumes of accounting entries. In the course of the review, we also reviewed internal controls for efficacy.

It is our opinion that Bank Center-invest is capable of internally generating accurate and timely financial statements that comply with International Accounting Standards (IAS), and that there is now enough knowledge of IAS in the bank to transform the existing Russian Accounting Standards (RAS) data to IAS compliant statements. We understand that at this point in time, this effort requires a manual transformation from RAS to IAS.

We would offer the following recommendations:

VI. Internal Controls

Replace internal controls layered onto existing processes with controls built into revised processes.

Layering on controls after the fact, for example, extra approval signatures or another check of work performed, consumes more time and resources than building the controls into the process as it is designed. In many instances, there is no additional risk for the bank. During some of the reviews conducted by your internal audit personnel, no instances of non-compliance have been found. Much of the work being done by the internal audit group is only for compliance, not to measure risk.

Processes could be analyzed by breaking them down into their component tasks and eliminating or replacing steps or controls that do not add value for the client or the bank or provide appropriate levels of control for the risk involved. This could lead to increased productivity and improved client service by speeding up processing.

- Review and modify existing expense limits for managers for expense and capital purchases on an annual basis.

- Reduce the number of signatures in the purchase approval process, including eliminating the president's.

- Recognize that the budgeting process is an effective control, and use it to replace other redundant controls.

- Reduce the number of times the same people handle the loan package.

Reduce follow-up control, re-doing work multiple times to ensure accuracy, to the minimum the Central Bank of Russia will tolerate.

- Assess the risk involved in a task or step in a process and replace re-doing the work with a control appropriate to the risk involved. Examples are:

- Use zero-sum balancing more often to control, rather than a second person doing the same work.

- Eliminate follow-up control where the significance of a possible error does not warrant it.

Expand internal auditors' role.

- Expand the current software with a system that will accommodate budgeting by cost/profit center and that has integrated modules for all of the bank's products and services. This would reduce the bank's reliance on Excel spreadsheets and substitutes for software designed for specific purposes, e.g., securities trading and securities inventory tracking. A system with integrated modules would also reduce the risk of unauthorized activities and increase productivity by eliminating programming and clerical work.

Center-invest has very successfully used Excel to fill in where the computer software does not have modules and/or where the bank's requirements are more stringent than the CBR's and/or RAS. However, these programs are not designed to provide the level of

security bank transactions require. Although Center-invest's manual controls over the information moved through Excel is very good, there is the risk of unauthorized entries and hacker activity.

VII. Reduce the Need for Staff

Impose a hiring freeze.

The Managing Board declares that no additional staff will be hired and no layoffs will be made. As a position becomes "open," through retirement, the incumbent leaving for another bank, etc., the manager of that unit must justify to the Managing Board

- ❖ either filling that open position as defined or
- ❖ filling a newly defined position which better suits the changing needs of the work unit.

As volumes increase, do not add staff.

Make managers responsible for finding ways to respond to the increase in workload with the existing staff. For example, removing unnecessary controls will free staff familiar with the work and Center-invest's policies to take on new tasks or jobs.

VIII. Improve Client Sales and Service

Consider expanding the service to the client's by keeping the bank open at lunchtime. I witnessed potential clients starting up the steps to the offices where business clients are served, only to be turned back by a security guard telling them the offices were closed during the lunch break.

This change can be achieved by alternating the lunch schedule with half of the people going to lunch at one time and the remaining half going an hour later. I would also suggest that this change be made in each department.

The bank is open for business for eight hours per day. This expanded service would not increase costs but would increase the number of clients that could be served during the day.

Establish and measure standards of client service. Western banks are increasingly measuring performance against more than financial indices. Examples of these measure are:

- ❖ speed of service, such as how long does it take a client to make a deposit into an existing account.
- ❖ accuracy of service, how many mistakes are made in clients' statements and how quickly are they corrected.

Survey clients and non-clients and respond to their comments and suggestions.

Have the staff that opens new accounts and/or closes accounts ask the client why they are opening/closing an account and forward that information to the marketing department for collection and analysis.

Design a small client service survey form and make it available to clients all over the bank. Have the return address the marketing department where the data is analyzed.

Add new products and services such as

- ❖ ordinary drafts drawn on a correspondent in FX and
- ❖ locating a notary in the same building as the bank (the head office and each branch).

IX. Improve Management Reporting

Center-invest produces financial reports according to both RAS and IAS. The reports are accurate and contain all the necessary data. However, the reports could be pared down to essential information, redesigned to increase their readability, distributed further down in the organization, and, in some cases, produced more often.

Start with a user definition of desired reports. Define the data to be included, how detailed the data should be, to whom the report should be distributed and how often. Once these decisions are made, the reports can be designed in a standard format with identifying numbers.

When Center-invest begins to measure non-financial service quality, management reports will have to be designed for these measures.

The bank now has a non-qualified opinion on the financial statements prepared by PricewaterhouseCoopers. This is positive news for the bank. I would also recommend Center-invest disseminate the information to every shareholder. I would also give a copy to as many clients as possible. You realize the importance of creating trust, stability and confidence in the bank and in the banking sector as a whole. Providing more information about the status of the bank will enhance the trust of depositors and help the bank grow to achieve its goals in the strategic plan. In addition, I would give employees a copy of the statement and share the positive news with them.

X. Strategic Planning

Center-invest has developed a strategic plan. The bank needs a plan complete with Strategic Objectives and Strategic Tasks that every employee is aware of. As the bank continues to grow, the existing software and hardware will need to be expanded. In order to decide which data processing system is the right one, to design management reports

that reflect the measures that bank management needs, and to compensate employees for results that advance the banks goals, employees need to know what those goals are.

XI. Policies and Procedures

During our discussions on IAS, we recognized several areas that will need to have new policies and procedures approved for the Board of Directors of the bank. Most of the new policies and procedures deal with decisions that will have to be made by someone in the accounting department. By creating the basis for the decision, the Board will direct the accounting personnel to make the decision desired by the Board and the management of the bank.

The following are examples of areas that could be affected.

- A. Low value items are no longer accounted for but someone is keeping track of all of these items. In my opinion, the cost and effort is a waste and is not necessary. The administrator who is responsible for purchasing supplies could assume this function.
- B. IAS-39 requires classification of securities and financial instruments when the bank makes a purchase. All financial instruments and securities held by the bank also have to be classified. I would suggest the Board approve a policy in accordance with IAS-39 and instructions from the CBR.
- C. IAS discusses materiality as a measurement of what is important. The bank needs to decide the level of materiality needed for disclosure in certain instances. I would suggest the Board approve a new policy on materiality in accordance with IAS.
- D. The IAS on "Investments in Associates" allows two methods of accounting – equity and cost. The bank should decide which method to use and then consistently apply that method. The Board will need to decide on the policy.
- E. Accounting under IAS is based on substance over form. There are some instances (such as capital leasing, accounting for discounts and premiums and repurchase agreements) where there is a conflict between the treatment between RAS and IAS. The Board should adopt a policy that reports based on IAS will be dependent upon application of all of the standards and guidelines outlined in the framework of IAS.

Thank you again for all of your assistance and hospitality while we were in Rostov-on-Don. We wish you and all persons associated with the bank the very best in all aspects of your endeavors.

Sincerely,

Phillip W. Smith
Resident Advisor

United States Agency for International Development

**Development Alternatives, Inc.
Central Bank of the Russian Federation
Building A, Room 333
12 Neglinnaya Street
Moscow, 103016 Russia**

**Telephone/Fax 095 929 48 73
Email: philip_smith@dai.com
DAI-Moscow@www.cbr.ru**

May 11, 2001

Ms. Ludmila I. Gudenko
Chairwoman, Accounting Working Group, IACC
Chief Accountant
Central Bank of Russia
12 Neglinnaya
Moscow 103016 Russia

Mr. Nicolai Semenov
Head - Accounting Methodology Unit
Central Bank of Russia

Mr. Michail Sukhov
Deputy Director, Prudential Supervision
Central Bank of Russia

Mr. Vladimir Medoev
Project Management Specialist
Office of Economic Policy Reform
USAID Russia
19/23 Novinsky Blvd.
Moscow 121099 Russia

RE: Final Report on Pilot Banks
Russia Bank Accounting Reform Project

Dear Ms. Gudenko and Gentlemen:

We are pleased to provide herewith copies of the final reports that have been issued to each of the two pilot banks. The banks, ProbusinessBank of Moscow (PBB) and NBD Bank of Nizhny Novgorod (NBD), have received these reports and are aware of the contents.

Pilot bank final reports
May 11, 2001
Page 2

During the last four months, we met with the representatives of each bank. During the process of our work at the banks, we reviewed accounting transactions in the five primary core areas of business; deposits, fixed assets, foreign exchange, loans and securities. We also reviewed the internal controls in each area and in the bank as a whole. The internal management reports used by the bank were reviewed as part of the background information we developed at each of the banks. Many, but not all, of the written procedures for accounting for transactions at the banks were reviewed during our work.

Our work at the banks also included training. We presented workshops at each bank that described the current differences between Russian Accounting Standards (RAS) and International Accounting Standards (IAS). Participants in the training received two texts; International Accounting Standards, 1999 (IASC, London) and A Practical Guide to International Accounting Standards (World Bank, Washington). There were also supplemental materials distributed to the participants during the training sessions. More than 36 participants from the two banks attended some or all of the workshop sessions.

Our project has been coordinating our work with the Tacis project being conducted by PricewaterhouseCoopers (PwC). PwC is originating the draft for the proposed instructions and formats that are intended to eventually be used by commercial banks in their reporting to the Central Bank of Russia (CBR). The pilot banks have received the initial drafts that have been released by PwC. In addition, both pilot banks are sending representatives to training being conducted in Moscow by PwC. PwC has graciously agreed to continue working with the two banks as part of their on-going work on the Tacis project.

These two pilot banks are recording transactions based on RAS. RAS are required under the current legislation and laws of the Russian Federation. The recording of the transactions is also based on current instructions and guidelines issued by the CBR. The external auditors of both banks prepare annual financial statements in accordance with IAS.

Both banks are currently creating financial statements that will comply with IAS. We reviewed the methodology used by the banks to transform the accounting data from RAS to IAS. We also reviewed the final IAS financial statements currently being generated through the transformation. Because of the excellent quality of the transformation at NBD, we recommended that they share the format and methodology with other commercial banks.

Pilot bank final reports

May 11, 2001

Page 3

The reports enclosed herewith include a cover letter with some recommendations to each bank plus the details of each area reviewed. These reports will also be included within the final report as presented to USAID. Both banks have made significant progress in their transition to IAS compliant reporting. Our recommendations will assist them in increasing the usefulness of their accounting reports and contribute to their long-term credibility and transparency.

In our opinion, both of the pilot banks have the ability to generate transformed financial statements in compliance with IAS on a monthly or quarterly basis from this time forward. We were highly impressed with the diligence with which the banks' staff attended and participated in our IAS seminars. They gained significant knowledge of IAS. As a result, we feel these two banks will easily progress to the adoption of the new guidelines and formats when issued by the CBR.

Thank you for the opportunity to work with these pilot banks and for the support you have given to us throughout our project.

Sincerely,

Philip W. Smith
Resident Advisor

CC: ProbusinessBank
NBD Bank

United States Agency for International Development

**Development Alternatives, Inc.
Central Bank of the Russian Federation
Building A, Room 333
12 Neglinnaya Street
Moscow, 103016 Russia**

**Telephone/Fax 095 929 48 73
Email: philip_smith@dai.com
DAI-Moscow@www.cbr.ru**

July 30, 2001

Ms. Ludmila I. Gudenko
Chairwoman, Accounting Working Group, IACC
Chief Accountant
Central Bank of Russia
12 Neglinnaya
Moscow 103016 Russia

Mr. Nicolai Semenov
Head - Accounting Methodology Unit
Central Bank of Russia

Mr. Michail Sukhov
Deputy Director, Prudential Supervision
Central Bank of Russia

Mr. Vladimir Medoev
Project Management Specialist
Office of Economic Policy Reform
USAID Russia
19/23 Novinsky Blvd.
Moscow 121099 Russia

RE: Final Report on Center-invest - Pilot Bank
Russia Bank Accounting Reform Project

Dear Ms. Gudenko and Gentlemen:

We are pleased to provide herewith copy of the final report that has been issued to Center-invest bank in Rostov-on-Don. The bank has received this report and is aware of the contents.

Pilot bank final report

July 30, 2001

Page 2

During the month of July, we met with the representatives of the bank. During the process of our work at the banks, we reviewed accounting transactions in the five primary core areas of business; deposits, fixed assets, foreign exchange, loans and securities. We also reviewed the internal controls in each area and in the bank as a whole. The internal management reports used by the bank were reviewed as part of the background information we developed at the banks. Many, but not all of the written procedures for accounting for transactions at the banks were reviewed during our work.

Our work at the bank also included training. We presented workshops at the bank that described the current differences between Russian Accounting Standards (RAS) and International Accounting Standards (IAS). Participants in the training received two texts; International Accounting Standards, 1999 (IASC, London) and A Practical Guide to International Accounting Standards (World Bank, Washington). There were also supplemental materials distributed to the participants during the training sessions. About 10 participants from the bank attended some or all of the workshop sessions.

Our project has been coordinating our work with the Tacis project being conducted by PricewaterhouseCoopers (PwC). PwC is originating the draft for the proposed instructions and formats which are intended to eventually be used by commercial banks in their reporting to the Central Bank of Russia (CBR). The pilot bank has received the initial drafts that have been released by PwC. In addition, the bank is sending representatives to training being conducted in Moscow by PwC. PwC has graciously agreed to continue working with the bank as part of their on-going work on the Tacis project.

This pilot bank is recording transactions based on RAS. RAS are required under the current legislation and laws of the Russian Federation. The recording of the transactions is also based on current instructions and guidelines issued by the CBR. The external auditors of the bank prepare annual financial statements in accordance with IAS. This year the statements were unqualified.

Center-invest bank is currently creating financial statements that will comply with IAS. We reviewed the methodology used by the bank to transform the accounting data from RAS to IAS. We also reviewed the final IAS financial statements currently being generated through the transformation.

Pilot bank final report

July 30, 2001

Page 3

The letter enclosed herewith includes some recommendations to the bank. This report will also be included within the final report as presented to USAID. The bank has made significant progress in the transition to IAS compliant reporting. Our recommendations will assist them in increasing the usefulness of their accounting reports and contribute to their long-term credibility and transparency.

In our opinion, this pilot bank has the ability to generate transformed financial statements in compliance with IAS on a monthly or quarterly basis from this time forward. We were highly impressed with the diligence with which the banks' staff attended and participated in our IAS seminars. They gained significant knowledge of IAS. As a result, we feel this bank will easily progress to the adoption of the new guidelines and formats when issued by the CBR.

Thank you for the opportunity to work with the pilot bank and for the support you have given to us throughout our project.

Sincerely,

Philip W. Smith
Resident Advisor

CC: Center-invest bank

Memo

To: Sergei Leontiev, President, ProbusinessBank
Vadim Kulik, Vice President
Natalia Stolpovshkih, Head, Banking Technologies Department
Christopher A. Bloomfield, Coordinator, Re-engineering Programme

From: Colleen L. Booth, Technical Advisor
Development Alternatives Inc.

Date: 5 June 2001

Re: Findings and Recommendations of Analysis of Opening an Account in Rubles for a Legal Entity

Under the auspices of the U.S. Agency for International Development, I spent three days examining the process of opening a current account in rubles for a legal entity, May 29 through May 31, 2001. This is a very short time, but the staff was very helpful, and we were able to accomplish a great deal.

The current process was flowcharted, as was the recommended revision to the process. Those flowcharts are included with this letter.

The following findings and recommendations were provided to Ms Natalia Stolpolvskih on the 31st: At her and Vadim Kulik's request, they are practical, detailed and can be adopted immediately.

1. Finding

Opening a current account in rubles for a legal entity takes too long. The time required for the Tax Authorities to approve an account is the "rate determining step." It can take up to a month.

Recommendations

Create a competitive advantage over other banks in Moscow by decreasing that time. Assign a bank courier the responsibility of delivering the Notifications of Intent to Open Account, expediting the processing of the notice, and picking-up the completed approval to open the account.

The Notification is usually mailed to the Tax Authorities, taking two or three days to get there. The Tax authorities are supposed to fax the approval back to the bank, but rarely do.

The client sometimes visits the Tax Authority to expedite the processing and to pick-up the approval, or the client's Relationship Manager may do so. By sending a bank courier, the Relationship Managers will not spend their time on an administrative function. They will

have more time for sales efforts. Clients will not spend their time on an unpleasant administrative function that they then associate with opening an account at ProbusinessBank.

2. Finding

Prospective legal entity clients are categorized according to length of time in business, and the risk of opening an account for a fictitious entity is well controlled. However, the opportunity for opening accounts for established businesses more quickly is not taken.

Recommendations

Prepare and courier the Notification of Intent to Open an Account earlier in the account opening process for established businesses than for the more risky potential clients. Courier the notification immediately after the New Accounts Specialist glances through the documents to ensure that all the required documents are there, but before the legal review of the documents has been initiated.

It may also be possible to open an account to deposits and therefore send the notification early for category III (newest businesses) prospective clients if they deposit a required minimum amount and agree to pay to close the account if their documents are found fraudulent or invalid by the Information and Analytical Department. Even if they are not in a financial position to do so, ProbusinessBank will have made the offer, which competitors are not doing.

3. Finding

Confusion amongst the staff regarding bank management's desired goals with regard to opening new accounts for other than corporate clients is hampering the bank's efforts at increasing its deposit base and the sales of fee based services. While Relationship Managers have been given the responsibility of increasing the Bank's deposit base, they feel that bank management is not interested in the small or medium client unless it will be very profitable. Instead of aggressively pursuing every prospective client and determining from their business with the bank whether they are profitable or not, marketing officers are doing nothing. Support officers see this apparent lethargy and morale suffers.

Recommendations

Clarify the message immediately with a brief letter to all employees from the President or the Managing Board re-emphasizing bank management's desire to increase the bank's deposit base and stating from which business sectors and sizes this growth is to come. State in the letter that all employees are expected to cross-sell services to potential clients and to give all prospective clients the very best customer service.

Proceed rapidly to publish the Bank's Mission Statement, which will focus the Bank's efforts on its selected market. Post the Mission Statement in all departments and branches, customer contact and non-customer contact.

Complete the Bank's strategic planning and publish the entire plan within the bank. This will inform all staff exactly which direction(s) executive management wants the staff's efforts to go.

4. *Finding*

The staff expected to sell deposit accounts and other fee services lack basic sales skills. This is one of the main reasons the bank's growth goals are not being met.

Recommendations

Beginning with the disgruntled Relationship Managers for small to medium enterprises, provide a serious, basic sales training course to employees that includes, identifying prospects, sales follow-up, the differences between features and benefits, overcoming objections and closing a sale. Practice tactfully turning a client away would be helpful also. Convey management's expectation that the skills will be acquired and used.

5. *Finding*

The Information and Analytical Control staff is responding very well to the client's needs by responding by fax to the New Accounts staff in one day.

Recommendations

Recognize this excellent achievement. Publish it in the bank newsletter. Reward the responsible staff in some way, with one-time bonuses or favorable comments in their performance evaluations.

Reduce the department's standard to 24 hours. Are there other service standards that are too long to encourage staff to create ways to shorten them?

6. *Finding*

Existing loan clients are not required to open a settlement account to conduct their business.

Recommendations

Have Relationship Managers communicate to clients that they are "expected" to open accounts to facilitate carrying out their business with the Bank.

7. *Finding*

Customer contact (sales) employees are not easy for prospective clients to find, their telephone numbers are not prominently displayed on the web site, and the bank's telephone system and telephone operators do not encourage callers to talk to sales personnel.

Recommendations

Give all customer contact personnel business cards. Make sure Relationship Managers' number are prominently listed in all advertising and on the web site. The new accounts staff have a great deal of telephone contact from prospective clients. Immediately move them into

view in the Operations Lobby, perhaps to the two vacant desks. Prominently display all customer contact telephone numbers on the website. Teach the bank's telephone operators to courteously determine whom the caller needs to speak with and re-record the message on the telephone system with a friendlier, more directive message.

8. *Finding*

All employees are not maintaining professional dress and/or personal hygiene standards. This Technical Advisor saw dirty hands and fingernails on customer contact personnel. That is not acceptable.

Recommendations

Write a brief dress code with guidelines rather than rules that says that all employees must dress professionally and maintain the highest standards of personal hygiene. An example of professional dress for men might be suit, shirt and tie or sweater, slacks and tie, shirt and tie in the heat of summer. For women, a similar example might be suits or professional dresses. Dress pants and blouses or sweaters in non-customer contact areas.

Provide examples of unacceptable dress. No blue jeans or athletic shoes. No T-shirts or shorts. No spaghetti strap tops or provocative necklines or hemlines. If you wish, you can specify no mini-skirts. Leave taste to the discretion of the section or department manager.

Make the dress code part of the personnel information given to every new and current employee.

Use the implementation of the dress code as an opportunity to remind managers and supervisors that they are expected to set an example of professional dress and behavior.

9. *Finding*

Signage in the bank's operations building is inadequate. Signage should direct the client so clearly that he does not have to ask guards or others for directions to specific departments and services. A receptionist is included in the Bank's plan for remodeling and opening up the stairwell, but that receptionist is there to help people who need it, not direct every person.

Recommendations

Define client areas with signs telling the client where to go and where not to go, e.g., post a sign on the stairwell door that leads downstairs that clearly says, "Employees Only." Keep the door closed. Put a similar sign on the glass doors to the "smoking section." Put a sign at the top of the first floor stairs that directs clients to the "Kacca" around the corner. Put a sign in the stairwell as it goes up to the third and fourth floors identifying again which offices are on which floors.

10. *Finding*

ProbusinessBank feels they are losing prospective clients to the foreign banks in Moscow. This is probably true. Trust is a factor. Foreign banks are felt to be more stable than Russian banks.

Recommendations

Change the corporate look and culture of ProbusinessBank to emphasize the bank's stability and to appear more western.

Move security guards to more inconspicuous locations. Decide exactly what they are protecting and locate them to carry out that protection.

Remove the requirement for "passes" for clients and visitors unless they are going to an "employees only" area of a building. All requiring passes does is cost the client time. Irritating clients is not worth the infinitesimal increase in security.

Choose a theme for advertising, corporate literature and reports, and make sure it is consistent throughout. Every piece of paper a client or the public handles or sees should communicate the bank's message, "We're stable, prosperous and trustworthy."

ProbusinessBank survived 1998. That is a significant factor in building trust with potential clients. Use it to good advantage. Put the bank's founding date on promotional literature and in ads. Publicly celebrate the bank's birthday every year with ads and banners and even parties for clients. Do everything possible to put this fact in front of clients and prospective clients.

Be more open with financial information. Make copies of the bank's annual report visibly available to all clients. Even if they don't read them, clients will feel more positive toward a bank that is not ashamed of its financial results.

Insist on superior cleanliness of bank facilities. For example, the stairwell that every business client uses to get to the operations lobby and the cashiers is dirty. The cleaning staff constantly mops the center of the stairs. Dirt has accumulated along the sides and in the cracks in the marble. The dusty blinds on the one window in the first course of stairs are kept closed because the view is unattractive, so the lighting is dim. Better to put translucent glass in the window and get rid of the dirty blinds. This stairwell does not project the image of a prosperous, stable, trustworthy bank.

Set up routine, repetitive schedules for painting and carpet cleaning. These expenses are an ordinary part of doing business. For example, the paint along the corridors in the operations building is scuffed and dirty and the carpets need tightening and cleaning. Again, this does not project the image ProbusinessBank needs to entice clients from other banks.

enclosures: two flowcharts

Agenda for Training at IAS Seminars

The following agenda and material was used to present the information during the various IAS seminars presented during the project.

NOTE: Memo #6 is 39 pages and is not included.

INTERNATIONAL ACCOUNTING STANDARDS (IAS)

DAY ONE

1. Thank the sponsor of the group of participants.
2. INTRODUCTIONS
 - a. Phil Smith
 - b. Interpreter
 - c. Members of the group (complete sign in sheet with full name, department and telephone number)
3. Schedule and housekeeping rules with breaks and restroom locations
4. Icebreaker – 9 dots
5. IASC background
 - a. Founded in 1973 by Australia, Canada, France, Germany, Japan, Mexico, Netherlands, United Kingdom, Ireland, and USA
 - b. At Jan 1, 1999 there were 142 members in 103 countries
 - c. Objectives of IASC
 - i. To formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their worldwide acceptance and observance, and
 - ii. To work generally for the improvement and harmonization of regulations, accounting standards and procedures relating to the presentation of financial statements.
 - d. How the framework and standards are set up.
 - e. How new standards are put in place.
6. This presentation is based upon a major assumption – that each participant has a good working knowledge of basic accounting and knows the Russian Accounting

Standards (RAS). We are not teaching RAS, we will concentrate on the differences between IAS and RAS as they relate to financial institutions.

7. Why IAS? Example attached – “I am an investor....”
8. Reasons why RAS differs from IAS.
9. Why RAS? Example attached. Why not IAS?
10. Process of converting to IAS – “Problems of Conversion”
11. Primary differences between RAS and IAS (Memo #6 attached in Russian and use English as guide)
12. Process of converting (list attached)
13. Process of converting to IAS (not in order of importance)
 - a. Training of personnel in CBR accounting and supervision departments
 - b. Training of accounting and other personnel in commercial banks
 - c. Accounting rules, instructions and regulations of CBR to be reviewed and amended as needed
 - d. Federal laws on accounting to be reviewed and changed if possible (working with the Legal department of CBR)
 - e. Pilot bank projects to develop ideas, test changes, and prepare case studies
 - f. New software to be developed for IAS module for parallel set of books to be posted beginning with every transaction.
14. Ideas to make our work better:
15. Reading material assignment for next day.

Daily after Day One:

Pick up from previous day.

Answer any questions from the material.

Ideas or thoughts about the material covered.

Discuss new material.

Reading assignment for next day.

Differences between RAS and IAS

See Memo #6 handout (39 pages)

1. Accrual accounting – accrue interest income and expense when they occur instead of recording income and expense when received or paid.
Reversal of interest accrual if past due.
2. Depreciation of fixed assets are based on different percentages
3. Valuation of securities
4. Loan loss provisions and classification of loans
5. RAS requires losses to be classified as assets
6. Consolidation - for RAS assets and liabilities of a subsidiary do not have to be consolidated. Leads to overstatement of assets and liabilities
7. RAS balance sheet generally reflected in reverse order – in order of increasing liquidity
8. Disclosure requirements
9. Derivative instrument provisions
10. Mark-to-market of debt securities – revaluation of securities.
11. REPO/Swap is an obligation to pay and is a liability (p.9)
12. IAS 29 effects of inflation
13. Correction of prior period statements for errors and changes in policy
14. Substance over form for REPO, Capital Lease and Investment Loans (p 12, 13,14)
Investments in affiliates are not loans.
15. Measurement criteria (p 15-16)
16. Discounts and premiums on investments – effective interest rate.

Other Principles of IAS

Consistency (p6)

Comparability p 6-7, p 18)

Prudence (p7)

Understandability (p 17)

The secrecy laws restrict disclosures

Readers need extensive and detailed knowledge of RAS

Reliability

Neutrality

Sale and repurchase allowed under RAS

Materiality (p 20)

Why IAS?

Example: #1

I am an investor. I have \$100 million to invest in various businesses. My minimum return that I expect to receive is 20% - I will not invest in anything that will not give me the required return.

I receive proposals totaling \$150 million from various firms in Russia, Kazakhstan, Bulgaria, Bosnia and Poland. The proposals include financial statements of the firms. I begin to compare the potential investments to determine which investments appear to be the best – and which investments will provide the highest returns.

The financial statements of the Russian company are based on RAS. The financial statements of the other companies are based on IAS. When I attempt to compare the potential investments, there is no practical method to logically compare the financial statement of the Russian company to the other investments. For making appropriate economic decisions, the information in the different financial statements should be compatible.

Because I cannot make a logical comparison, my risk of investment increases! If I invest in the other four companies, the analysis reflects that I can get between 20% and 25%. The analysis is based on comparable IAS compliant financial statements. The Kazakhstani firm has a return of 24%, the Bulgarian firm is 24%, the Bosnian firm is 23% and the Polish firm is 21%.

But I think Russia has excellent potential and I would like to invest in Russia.

In order for me to invest in Russia, I need to get a higher return because of the higher degree of uncertainty and risk. The return on my investment must be higher than the amount I can get in the other investments.

The requirement to receive a higher return translates into a higher cost to the Russian company. I will require more than 25% because I can get that from other investments.

The use of IAS compliant financial statements will increase comparability. The result will be a reduction in the cost of capital. That one result is a substantial benefit.

Capital providers, in setting the criteria they use in making their financial decisions, are a very strong influence on what accounting is used and what auditing standards are practiced. The capital providers, therefore, dictate the cost of capital.

Example #2:

Newspaper article:

Lukoil announced plans to increase the proportion of the net profits it pays out in dividends from 15-20% to 20-25%.

Why? Because they are using Russian accounting standards and realize they need to increase dividends to attract more investors? Perhaps.

Example #3:

Sverbank announced net profit of about \$285 million. But the article in The Moscow Times had serious questions about the validity of the financial information. If the CBR intends to privatize this bank, it will be necessary to have complete IAS financial statements and not just one year without comparison to prior years.

Why RAS?

Is it necessary to have standards that are different from other standards used in other countries?

In a recent edition of The Economist magazine, there is mention of IAS:

“The European Commission said it wanted all European Union countries to adopt IAS by 2005. The EU will also want a say in formulating new rules, which are set by a private body.”

The EU currently has observers who attend all IASC meetings where rules are discussed.

Why not IAS?

Use of IAS would be beneficial in several ways:

1. Reduce the cost of capital
2. Provide comparable financial statements
3. Provide transparency

COMPARABILITY

- Important for Banking Supervision
- Analysis of financial statements can be more realistic
- 3.2 of comparison of RAS to IAS

Materials to be copied for Handouts

Present Value and Future Value with tables – Russian version.

Case Study on Cash Flow Statement Preparation.

Loan classification and reserves for loan losses.

General ledger versus subsidiary ledgers.

Discussion of instruction 17 on accrual accounting.

Memo #6 for differences in RAS and IAS – Russian version.

Materials to be distributed to participants

IAS Russian version.

ICAR translated revision of World Bank “Practical Guide to IAS.”

Memo #6 Russian version.

Present Value Russian version.

Copy of IAS #39 Condensed Presentation

Copy of IAS #40 Condensed Presentation

Copies of IAS #40 in Russian from IASC.

Example of Swap

Interest rate increase scenario

1) The bank has funded 10 million loans. The loans have maturity of five years. The loans have a fixed rate of interest at 8% per year.

The bank accepts deposits in the form of Certificates of Deposits. The term of the CDs is one year. The rate for the first year is 7.5%. The interest rate rises in each of five years. The increase is .5% per year.

In the first year, the bank will have a profit of 50,000 between the interest earned on loans and the interest paid on the deposits. In a rising interest rate environment, the bank could lose the spread during the five – year period.

The loan and deposit balances are shown below. The interest income and expense is also shown.

8% - foxed rate loan (5 years)		1 year CDs	
10 million.		10 million.	
		Or Eurobonds with longer term	
Interest income on loans		Interest expenses / CDs	
Years:1) 800,000		Years:1) 750,000	
2) 800,000		2) 800,000	
3) 800,000		3) 850,000	
4) 800,000		4) 900,000	
5) 800,000		5) 950,000	

2) The bank makes a decision to protect itself against possible increases in rate. It enters into variable rate swap for 10 million. (The seller of swap could be a pension fund who wishes to have fixed income at 7.5% over the five - year period).

The long position is reflected for the variable rate swap. The income for the variable rate swap increases each year during the period and is shown in the long position.

The short position is reflected in the fixed rate swap. The expense for the fixed rate swap remains the same each year through the period.

The net swap income is shown. There is no income from the swap in the first year.

SWAP – variable rate

*	
---	--

Income/Losses

	Year: 1) 50,000
--	-----------------

Long position

Interest

Income on **SWAP** – variable rate
10,000,000 at par

	1) 750 000
	2) 800 000
	3) 850 000
	4) 900 000
	5) 950 000

Short position

(Interest expenses)

7.5% variable rate SWAP
10.000,000 at par

1) 750 000	
2) 750 000	
3) 750 000	
4) 750 000	
5) 750 000	

Net income on SWAP

1) 0
2) 50,000
3) 100,000
4) 150,000
5) 200,000

* **SWAP par amount is not established as an asset or liability.**

3) The bank has a positive interest spread in the first year in the amount of 50,000 from loans and deposits. In the second year, the net profit from the loans and deposits is zero. The bank has expenses in excess of income for the loans and deposits in the third, fourth and fifth years.

The bank also has net income from the swap in the second through the fifth years. The amount in the second year is 50,000 and increases by 50,000 each year from the third to the fifth year.

The interest income on the swap is a match to the expenses for the interest on the CDs. The interest income on the loans is offset, or reduced, by the expense of the fixed rate swap.

<u>Total</u>	<u>Total</u>	NET
<u>Income</u>	<u>Expense</u>	
1- 1550,000	[1500,000]	50,000
2- 1600,000	[1550,000]	50,000
3- 1650,000	[1600,000]	50,000
4- 1700,000	[1650,000]	50,000
5- 1750,000	[1700,000]	50,000

Net income +
Net cash flow

Interest income on loans plus interest received on swap equals total income (inflow). Interest expenses on deposits plus interest paid on them equal total expenses (outflow).

The net result of the swap is a constant stream of income of 50,000 per year for the five year period. The net cash flow is also 50,000 each year when the interest is paid on all accounts.

(Tax issue – the interest could be deducted)

RUSSIA BANK ACCOUNTING REFORM PROJECT

CASH FLOW STATEMENT PREPARATION

INSTRUCTOR MANUAL

Prepared by

Philip W. Smith
Development Alternatives, Inc.

Under the auspices of

United States Agency for International Development

Last Revision - April 25, 2001

CASH FLOW STATEMENT TRAINING SESSION

AGENDA

DAY ONE:

- I. AMENDMENTS AND CHANGES NOT APPROVED BY THE CBR
 - A. WHAT IS IT? (EXHIBIT 1)
 - B. CBR RULES AND GUIDELINES
 - C. INTERNATIONAL ACCOUNTING STANDARD 7
 - D. PRODUCED ANNUALLY BY EACH BANK
 - E. USE EITHER THE DIRECT OR INDIRECT METHOD (SEE FORMATS IN IAS 7)
 - F. TYPES OF ACTIVITIES
 - 1. OPERATING
 - 2. INVESTING
 - 3. FINANCING
 - 4. FOREIGN EXCHANGE MOVEMENTS
 - F. REFLECTS MOVEMENTS OF CASH
 - 1. NOT CASH BASIS ACCOUNTING
 - 2. NOT AN INCOME STATEMENT
 - 3. PREPARED FROM BOOKS KEPT ON ACCRUAL BASIS
 - 4. NON-CASH TRANSACTIONS ARE TAKEN OUT
 - 5. INCREASES AND DECREASES IN CASH EFFECTING BALANCE SHEET ACCOUNTS ARE RECOGNIZED
 - 6. SHOWS OPERATING EFFICIENCIES OF THE BANK
- II. HOW TO PREPARE THE STATEMENT
 - A. EXHIBIT 2
 - B. THINGS TO THINK ABOUT WHEN YOU BEGIN

DAY TWO

- III. PREPARATION OF THE CASH FLOW STATEMENT - CASE STUDY
 - A. START WITH WORKPAPER
 - 1. BEGINNING TRIAL BALANCE
 - 2. ENDING TRIAL BALANCE
 - B. DIFFERENCES
 - C. NOTES OF SPECIFIC SITUATIONS CONCERNING ACCOUNTS
 - D. DEFINE CASH AND CASH EQUIVALENTS

- E. DEFINE UNREALIZED GAINS AND LOSSES
- F. ACCRUALS ARE EXAMINED FOR DIFFERENCES
- G. NON-CASH ITEMS ARE CALCULATED
 - 1. DEPRECIATION
 - 2. AMORTIZATION
 - 3. RESERVES
 - 4. NET INCOME OR LOSSES FROM SUBSIDIARIES
 - 5. LOAN WRITE-OFFS
 - 6. LOANS OR STOCK ISSUANCE USED TO PURCHASE ASSETS ARE NOT REFLECTED IN THE CASH FLOW STATEMENT.

IV. INTERPRETATION OF THE RESULTS

- A. WHERE DID THE CASH COME FROM?
- B. WHERE DID THE CASH GO/
- C. ASSETS SOLD TO FINANCE OPERATING ACTIVITIES?
USE THE W. T. GRANT EXAMPLE.

V. QUIZ

HANDOUTS:

- 1. CBR GUIDELINES AND FORMATS
- 2. IAS 7
- 3. CASH FLOW STATEMENTS – EXHIBIT 1
- 4. CASH FLOW STATEMENT PREPARATION – EXHIBIT 2
- 5. CASE STUDY - 12 PAGES

CASH FLOW STATEMENT PREPARATION - CASE STUDY FOR BANK TRAINING

AbB Fundamental Bank

List of selected transactions for current year that have an impact on cash flow in millions of Local Currency (LC):

1. Sold obsolete computers for 100. At the time of sale, the net book value of the computers was 160 (acquisition cost of 200 less accumulated depreciation of 40).
2. Purchased new computers for 300.
3. Purchased new furniture for 50.
4. Acquired new vehicles under capital lease terms. The fair value of the vehicles is 1,000. The bank made a down payment of 100 reducing its lease obligation to 900. At the end of the year, after 7 monthly lease payments, the lease obligation was reduced to 773. See Capital Lease worksheet for additional information.
5. A 1,000 loan was written off. The beginning specific reserve balance applicable to this loan was 300. Collateral that was repossessed as a result of the write off was valued at 600. Therefore, to write off the loan, the bank had to provide additional specific reserves of 100.
6. The remaining part of the provisions for loan losses in current year (including both specific and general) totaled 2,200.
7. Amortization of premiums and discounts on securities purchased during the year is 1,400. Because the amortization is a non-cash expenditure, it is added to the income to determine the net cash flow.
8. Unrealized income and losses from the sale or revaluation of securities and foreign exchange transactions are not included. If the bank had such items, the amounts would be added (income) or subtracted (losses) to/from income to determine the net cash flow.
9. During the year the bank invested in securities and disbursed more loans. The new funds were from deposits and new capital. For detailed information see the comparative balance sheet and supporting schedules.
10. The bank increased its capital by issuing 1,000 shares of common stock and 2,000 shares of preferred stock.

Date references are X0 for the end of the previous year and X1 or XXX1 for the end of the current year.

AbB Fundamental Bank
Comparative Balance Sheet
(in millions LC)

ASSETS		Ending	Beginning	Net change
Account	Group	31/12/X1	31/12/X0	(outflow) Inflow
<i>Cash:</i>				
1000	Monetary assets *	3 400	2 400	1 000
1050	Correspondent accounts *	3 800	2 700	1 100
1100	Requirements of NBRK *	4 500	3 000	1 500
1150	Treasury obligations for refi *	6 500	4 500	2 000
1251	Overnight deposits*	1 500	900	600
1252	Short-term deposits (<1 month.) *	3 600	2 400	1 200
1253/1269	Other bank deposits	700	400	300
	TOTAL Cash	24 000	16 300	7 700
<i>Securities:</i>				
1200	Trading securities	10 000	4 000	<6 000>
1450	Other securities	14 500	9 500	<5 000>
1800	Premiums and discounts	<1 800>	<1 400>	400
	TOTAL Securities	22 700	12 100	<10 600>
<i>Loans:</i>				
1300	Loans to banks	14 000	7 000	<7 000>
1400	Loans to customers	65 150	48 000	<17 150>
1460	Provisions for loan losses	<6 150>	<3 850>	2 300
	TOTAL Loans	73 000	51 150	<21 850>
<i>Fixed Assets:</i>				
1650	Fixed assets	7 400	6 250	<1 150>
1690	Accumulated depreciation	<1 900>	<1 175>	725
	Net Fixed Assets	5 500	5 075	<425>
1470	Investments in subsidiaries	1 200	700	<500>
1700	Accrued interest receivable	1 400	850	<550>
<i>Other Assets:</i>				
1550	Settlements	400	375	<25>

1600	Tangible assets	300	300	0
1750	Prepaid interest	50	40	<10>
1850	Other debtors	140	140	0
1900	Temporary assets	0	0	0
	TOTAL Other Assets	890	855	<35>
	TOTAL Assets	128 690	87 030	41 660

- - cash and cash equivalents

LIABILITIES		Ending	Beginning	Net change
<i>Group</i>		31/12/X1	31/12/X0	(outflow) Inflow
<i>Account</i>				
<i>Deposits:</i>				
2010-23	Demand deposits	66 000	41 000	25 000
2120	Time deposits	13 000	15 000	<2 000>
2200	Liabilities to customers	6 000	4 000	2 000
2250	CD's issued	12 000	2 000	10 000
	TOTAL Deposits	97 000	62 000	35 000
Borrowings:				
2110	Interbank borrowings	0	200	<200>
2050	Loans from banks	1 800	800	1 000
2550	Settlements	1 000	800	200
	TOTAL Borrowings	2 800	1 800	1 000
Other Debt:				
2300	<i>Securities issued</i>	8 000	8 000	0
2350	Refinancing	4 000	3 000	1 000
2400	Subordinated debt	0	0	0
	TOTAL Debt	12 000	11 000	1 000
2700	<i>Accrued interest payable</i>	2 974	3 330	<356>
Other Liabilities:				
2750	Prepaid income	300	100	200
2800	Premiums and discounts	0	0	0
2850	Other creditors	1 150	50	1 100
2900	<i>Temporary liabilities</i>	0	50	<50>
	TOTAL Other Liabilities	1 450	200	1 250

	TOTAL Liabilities	116 224	78 330	37 894
	EQUITY			
3000	Capital	6 000	3 000	3 000
3100	Paid in capital	3 000	3 000	0
3003/27	Purchased stock	<500>	<500>	0
3500	Reserves	2 000	2 000	0
-	Retained earnings	1 966	1 200	766
	TOTAL Equity	12 466	8 700	3 766
	TOTAL Liabilities and Equity	128 690	87 030	<41 660>
(Accounts 1350/2150 eliminated in consolidation)				

AbB Fundamental Bank
Income Statement
for the year ending December 31, XXX1
(in millions LC)

INTEREST INCOME

	<i>Group</i>	
4050	Correspondent accounts	495
4100	Deposits in NBRK	400
4150	Treasury obligations	990
4200	Securities available for sale	2 300
4250	Deposits – other banks	100
4300	Loans and advances to banks	2 200
4400	Loans and advances to customers	12 500
4450	Other securities	2 100
	TOTAL Interest Income	<u>21 085</u>

INTEREST EXPENSE

5020	Demand deposits	4 770
5050	Loans received	230
5090	Bank loan expenses	30
5110	Overnight deposits	110
5120	Money market	160
5200	Customer deposit	3 280
5250	CD's issued	720
5300	Securities and repos	480
5350	Refinance securities	320
	Total Interest Expense	<u>10 100</u>
	Net Interest Margin	<u>10 985</u>
	Other Operating Income (Schedule A)	<u>8 025</u>
	Operating Costs (Schedule B)	<u>17 925</u>

Net Profit from Operations

Extraordinary Gains and Losses (Schedule C)

Net Profit Before Income Taxes

5999 Income taxes

Net Profit After Income Taxes

1 085

10

1 095

329

766

**AbB Fundamental Bank
Schedule to Income Statement
for the year ending December 31, XXX1**

(in millions LC)

Schedule A – Other Operating Income

<i>Account</i>	<i>/ Group</i>	
4470	Capital investments	600
4500	Dealing transaction income	4 800
4600	Commission income	2 430
4800	Other operational income	110
4850	Sale or disposal of assets	<60>
4900	Fines, forfeits and penalties	90
4920	Other income	55
	TOTAL Other Operating Income	8 025

Schedule B – Operating Costs

5450	Loan reserves	2 300
5500	Dealing transaction losses	1 800
5600	<i>Commission expense</i>	1 280
5720	Payroll and associated costs	7 200
5740	General expenses	4 260
5760	Taxes (other than income tax)	90
5780	<i>Depreciation</i>	765
5800	Other operating costs	75
5850	Expenses and losses	45
5900	Fines, forfeits and penalties	60
5920	Other expenses	50
	TOTAL Operating Costs	17 925

Schedule C – Extraordinary Gains and Losses

4940	Extraordinary gains	70
5940	Extraordinary losses	<60>
	Net extraordinary gains and losses	10

AbB Fundamental Bank
Work Sheet – Cash Flow Statement
Cash and Cash Equivalents

	<u>Beginning of the year</u>		
Group	1000	Monetary assets	2 400
	1050	Correspondent accounts	2 700
	1100	Requirements of NBRK	3 000
	1150	Treasury obligations	4 500
	1251	Overnight deposits	900
	1252	Short-term deposits (<1 month.)	2 400
		TOTAL at beginning of the period	<u>15 900</u>
	<u>End of the year</u>		
Group	1000	Monetary assets	3 400
	1050	Correspondent accounts	3 800
	1100	Requirements of NBRK	4 500
	1150	Treasury obligations	6 500
	1251	Overnight deposits	1 500
	1252	Short-term deposits (<1 month.)	3 600
		TOTAL at end of the period	<u>23 300</u>
		Difference = Increase	<u>7 400</u>

**AbB Fundamental Bank
Breakdown of the
Statement of Cash Flows
for the year ended December 31, XXX1**

Cash Flows from Operating Activities		Account Balance Millions of LC		Cash Flows current year millions of LC
	<i>Group</i>	<u>Dr</u>	<u>Cr</u>	
	Net Income		766	
5999	Income taxes	329		
	Net income (loss) before income taxes			1 095
5780	Depreciation expense	765		765
5450	Reserves for loan losses	2 300		2 300
4500	Net amortization of discounts	1 400		1 400
4850	Income (loss) on sale of fixed assets	60		60
	Deferred taxes (all paid)	0		0
	Other adjustments	0		0
	Income (loss) before changes in operating assets			5 620
	(Increases)/ decreases in assets:	<u>Ending</u>	<u>Beginning</u>	<u>Change</u>
1700	Accrued interest receivable	1 400	850	<550>
1550	Settlements	400	375	<25>
1750	Prepaid interest	50	40	<10>
1200	Trading securities	10 000	4 000	<6 000>
1253/1269	Other bank deposits	700	400	<300>
1300/1400	Loans	79 150	55 000	<24 150>
	Written off loan	1 000		<1 000>
	Total (Increase)/decrease in assets			<32 035>
	Increases/(decreases) in liabilities:			
2000/2256	Deposits (net)	97 000	62 000	35 000
2110	Interbank borrowings	0	200	<200>
2550	Settlements	1 000	800	200
2700	Accrued interest payable	2 974	3 330	<356>
2750	Prepaid income	300	100	200
2850	Other creditors (except capital lease of 773)	377	50	327
2900	Temporary liabilities	0	50	<50>

	Total Increase/(decrease) in liabilities			<u>35 121</u>
5999	Income tax expense	329	0	<329>
		0	0	—
	Net cash flows from operating activities			<u>8 377</u>
	<u>Cash Flows from Investing Activities</u>	<u>Ending</u>	<u>Beginning</u>	<u>Change</u>
1470	Investments in subsidiaries	1 200	700	<500>
1450	Other securities	14 500	9 500	<5 000>
	Premiums and discounts			0
	Sale of fixed assets – computers			100
	Purchase of fixed assets – computers			<300>
	– furniture			<50>
	– vehicles/capital lease			<227>
	Net cash from investing activities			<u><5 977></u>
	<u>Cash Flows from Financing Activities</u>			
3000	Capital accounts	6 000	3 000	3 000
2050	Loans to banks	1 800	800	1 000
2350	Refinancing	<u>4 000</u>	<u>3 000</u>	<u>1 000</u>
	Net cash flows from Financing Activities			<u>5 000</u>
	Net increase (decrease) in cash and cash equivalents			<u><u>7 400</u></u>

AbB Fundamental Bank
Statement of Cash Flows
for the year ended December 31, XXX1

(in millions LC)

Cash Flows from Operating Activities:

1.	Net income/(loss) before income tax	1 095	
2.	Adjustments for:		
2.1.	(Recovery)/Provision for loan losses	2 300	
2.2.	Provisions for other types of potential losses	0	
2.3.	Depreciation	765	
2.4.	Unrealized (gain) loss on trading securities	0	
2.5.	Net amortization of discounts and premiums	1 400	
2.6.	Realized (gain) loss from investing activities	0	
2.7.	Deferred taxes	0	
2.8.	Investment activities	60	
2.9.	Other adjustments	0	
3.	Operating income before changes in operating assets and liabilities		5 620
4.	Changes in operating assets and liabilities		
5.	(Increase)/Decrease in operating assets:		
5.1.	Other bank deposits	<300>	
5.2.	Investments in government securities (trading)	<6 000>	
5.3.	Loans to banks	<7 000>	
5.4.	Loans to customers (net)	<18 150>	
5.5.	Accrued interest receivable	<550>	
5.6.	Prepayments	<10>	
5.7.	Other assets	<25>	
5.8.	Net Increase/(Decrease) in assets		<32 035>
6.	(Increase)/Decrease in operating liabilities		
6.1.	Loans and advance from banks	<200>	
6.2.	Customer accounts	35 000	
6.3.	Accrued interest payable	<356>	
6.4.	Taxes paid	<329>	
6.5.	Other liabilities	677	
6.6.	Net Increase/(Decrease)		<34 792>
7.	Net cash flows from operating activities		8 377

Cash Flows from Investing Activities:

8.	(Increase)/Decrease in investments	<500>	
9.	Net acquisition of securities	<5 000>	
10.	Net purchase of fixed assets	<477>	
11.	(Increase)/Decrease in other investing activities	0	
12.	Net cash flows from investing activities		<5 977>

Cash Flows from Financing Activities:

13.	Issuance/(Redemption) of capital stock	3 000	
14.	Resale/(Purchase) of treasury stock	0	

15. Proceeds (Repayment) of debt instruments	1 000	
16. Dividends paid	0	
17. (Increase)/Decrease in cash from financing activities	1 000	
18. Net cash flows from financing activities		5 000
19. Effects of exchange rate fluctuations		0
20. Net Increase/(Decrease) in cash and cash equivalents		7 400
21. Cash and cash equivalents, beginning of period	15 900	
22. Cash and cash equivalents, end of period	23 300	

AbB Fundamental Bank
Work Sheets - Cash Flow Statement

Calculation of balance of depreciation (accounts in group 1650/1690):

Accumulated Depreciation

	Debit	Credit
Beginning balance		1175
Sale of asset	40	
Depreciation expense		765
Ending balance		1900

Example of Unrealized (Gain) Loss on Trading Securities:

If the bank had unrealized loss from the revaluation of securities, the loss would be a non-cash transaction. The amount would be added to income in the operating activity section (line 2.4.). There was no cash involved, therefore it is a transaction similar to depreciation or amortization.

Realized gain or loss from investing activities (line 2,6) are deducted (income) from or added (loss) to the operating activity section. The amount would then be reflected on line 11 as an increase (loss) or decrease (income) in the investment activity section of the cash flow statement.

AbB Fundamental Bank
Capital Lease Schedule

Entries at inception
capital lease 1000
Date: June 1, XXX1
DR Bank vehicles held under
CR Capital leases for bank assets
900
CR Cash
100

Interim entries
... July 31
assets 17
leases 19
DR Capital Leases for bank
DR Interest Expense on capital
CR Cash
36

	Periodic monthly payments	Interest Expense	Total for the year	Reduction Outstanding Liability	in Total for the year	Outstanding liability
						900
June 30,	36	19		17		883
July 31,	36	19		17		866
August 31,	36	18		18		848
September	36	18		18		830
October	36	17		19		811
November	36	17		19		792
December	36	17		19		773
January 31,	36	16	125	20	127	753
February	36	16		20		733
April 30,	36	1		34		35
May 31,	36	1		35		(0)

Interest expense is the net pr Reduction in the lease liability is not recognized as expense but involves a cash

Actual use of cash

Cash down payment 100
Liability reduction 127
Total cash used 227

Exhibit 1

CASH FLOW STATEMENTS

The cash flow statement is an integral part of the financial statements.

It shows sources of funds and how the funds were used.

It is important because it shows the activity in acquiring and employing funds for a given period.

Since it is prepared for a specific period, only changes in the accounts from the beginning to the end of the period are relevant.

The statement is designed to show how the bank's operations have affected its liquidity, and show the relationships among cash flows from operations, investing and financing activities.

Is the bank generating cash to purchase fixed assets needed for growth?

Is growth so rapid that external financing is needed for operations?

Does the bank have excess cash that can be used to repay financing from earlier periods?

Information is useful for investment analysis and for management planning. Provides users of the statements with a basis to assess the ability of the bank to generate cash and cash equivalents and the needs of the bank to utilize those cash flows. The statement provides information that enables users to evaluate the changes in net assets, its financial structure (including its liquidity and solvency), and its ability to control the timing of cash flows to adapt to changing circumstances and opportunities.

Noncash items are added back. Depreciation and amortization are noncash items. Changes in assets and liabilities that do not require or use cash resources are noncash items and are not presented on the cash flow statement. Using new debt to purchase fixed assets does not use cash and neither the asset or liability are reflected on the cash flow statement (although a footnote may be appropriate).

CASH FLOW STATEMENTS

EXHIBIT 1

PAGE 2

Sources of cash:

1. Increases in cash from a liability or equity account. New deposits are a source of funds.
2. Decreases in asset accounts. Sale of a fixed asset or pay off of a loan receivable is a source of funds.

Uses of cash:

1. Decrease in a liability or equity account. Paying off a depositor is a use of funds.
2. Increase in an asset account. Funding a new loan to a customer is a use of funds.

FOREIGN EXCHANGE UNREALIZED GAIN OR LOSS FROM REVALUATION

EXAMPLE FOR CASH FLOW STATEMENT TRAINING

Unrealized gains and losses arising from changes in exchange rates are not cash flows. Therefore, unrealized gains and losses which are a result of revaluations are non-cash items and should be presented separately from cash flows from operating, investing, and financing activities.

Example:

The bank purchased \$10,000 US on December 25, 1998. The cost was 830,000 local currency (83 LC = 1USD).

At December 31, 1998 the USD exchange rate is 84 LC = 1USD. The position is revalued to 840,000 which results in a gain of 10,000 LC. The gain would be reflected in account 4530 at the end of the year.

The gain would be included in the net income on the income statement. The unrealized gain is a non-cash transaction that should be reflected on line 2.7 of the cash flow statement. It would be subtracted from the net income. The amount was not realized and the gain was not received by the bank.

The amount would be added to line 19, "Effects of exchange rate fluctuations."

EXAMINATION FOR CASH FLOW STATEMENT PREPARATION

Name: _____ Date: _____

QUESTIONS:

1. The bank sold some of its cars in the middle of 1998.
The initial cost of the cars was 300 000 local currency. The accumulated amortization at the date of sale was 150 000 local currency. The bank received 200 000 local currency for the cars which had been sold.
2. The balance on the Loans account at the beginning of the year was 1 000 000 local currency and 5 000 000 local currency at the end of the year. During the year the bank wrote off loans in the amount of 2 000 000 local currency.
3. The net profit for the year is 150 000 local currency.

Describe the way the events mentioned above would affect the cash flow.
Make the corresponding adjustments to the net profit.

Net profit	150 000
------------	---------

Adjustments to the net profit

OPERATING ACTIVITY

From the sale of fixed assets _____

Net change in loans _____

Total: cash flow from operating activity _____

INVESTMENT ACTIVITY

Cash flow from the investment activity _____

CHANGE IN CASH _____

IAS 39

Financial Instruments

Training Presentation

1. Summary	Pages S-1 to S-2
2. Definitions and Examples	IAS paragraphs 8 - 26
3. Recognition	IAS paragraphs 27 - 65
4. Measurement	IAS paragraphs 66 - 165
5. Disclosures	IAS paragraphs 166 - 170

This presentation is based on information contained in “International Accounting Standards 1999” published by International Accounting Standards Committee, London, United Kingdom. It is a summary of the material contained in the text. The original text should be referred to for questions concerning specific issues and for more examples.

Prepared by Philip W. Smith, Development Alternatives, Inc. under a technical assistance project funded by the United States Agency for International Development (Project No. OUT-PCE-1-802-99-00009-00).

IAS 39 Financial Instruments

S-1

Summary

1. This standard increases the use of fair value in accounting for financial instruments.

1.1 The use of fair value is required for the following:

- a. derivative assets and derivative liabilities;
- b. debt securities, equity securities, and other financial assets held for trading;
- c. debt securities, equity securities, and other financial assets not held for trading but are available for sale;
- d. derivatives embedded in non-derivative instruments;
- e. non-derivative financial instruments containing embedded derivative instruments that can't be reliably separated from the non-derivative financial instrument;
- f. non-derivative assets and liabilities that have fair value exposures being hedged by derivative instruments;
- g. fixed maturity investments not designated as held to maturity; and
- h. purchased loans and receivables not designated as held to maturity.

1.2 There are three (3) classes of financial assets that remain carried at cost for accounting purposes:

- a. loans and receivables originated by the enterprise;
- b. other fixed-maturity investments held to maturity; and
- c. unquoted equity instruments whose fair value cannot be reliably measured.

2. Recognition on the balance sheet

2.1 Initially measured at cost.

2.2 Subsequently measured at fair value (except for the above three classes mentioned at 1.2).

2.3 A single, enterprise-wide option is elected for accounting to either (a) recognize adjustments in net profit or loss for the period; or (b) recognize in net profit or loss for the period only changes in fair values relating to financial assets and liabilities held for trading.

2.4 Derecognition

3. Measurement

3.1 Initial measurement (para 66-67)

3.2 Subsequent measurement of financial assets (para 68-92) [Held to maturity at para 79-92]

3.3 Subsequent measurement of financial liabilities (para 93-94)

3.4 Fair value measurement considerations (para 95-102)

3.5 Gains and losses (para 103-107)

3.6 Impairment and uncollectibility of financial assets (para 109-119)

3.7 Hedging (para 121-165)

4. Disclosures

5. Four categories of financial assets

5.1 Held for trading to generate a profit in price or margin. Includes derivative financial assets and derivative financial liabilities unless they are designated and are effective hedging instruments.

5.2 Held to maturity which includes the *ability* to hold.

5.3 Loans and receivables originated by the enterprise (other than those which are originated with the intent to sell).

5.4 Available for sale which includes all other financial assets that do not fit into the first three categories.

6. The standard applies to financial statements covering periods beginning on or after January 1, 2001. Transition to this standard is described in paragraph 172.

IAS 39

2. Definitions

Fair value

the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. See paragraphs 95 to 102 for fair value measurement considerations.

Hedge Accounting (see paragraph 10 for definitions)

Hedging

designating one or more hedging instruments so that their change in fair value is an offset, in whole or in part, to the change in fair value or cash flows of a hedged item.

Hedged item

an asset, liability, firm commitment, or forecasted future transaction that exposes the enterprise to risk of change in fair value or future cash flow and is designated as being hedged.

Hedging instrument

designated derivative or other financial asset or liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item. If hedging the risk of changes in foreign currency exchange rates, a non-derivative financial asset or liability can be designated as a hedging instrument.

Hedge effectiveness

the degree to which offsetting changes in fair value or cash flows attributable to a hedged risk are achieved by the hedging instrument.

⌢ ⌢

Securitization Example - Page 2

4. Delta continues to service the loans and will receive 11/2% annually on the average remaining balance of the loan pool. Delta will be responsible for all servicing functions plus the payment of interest to the pension fund and the investor that purchased the interest-only strip. Delta is responsible to pay for the costs of servicing. The excess cash flow from the servicing can be recorded as an intangible asset (subject to IAS 38). The fair value would be measured based on the present value of the future cash flows. For this example, the assumption is made that the cost of servicing is equal to \$40,000 per year. The income from the servicing is estimated at \$75,000 per year (1 1/2% on an average outstanding balance of \$5,000,000 over the life of the mortgages). The net cash flow each year is estimated to be \$35,000 for the next ten years. The present value of the cash flows would be \$56,527 based on a ten-year term and a discount rate of 20%. The debit would be to Servicing Rights and the credit would be to Valuation Reserves for Servicing Rights (in the Equity section of the balance sheet). The asset would be amortized over the life of the mortgages. The earned income would be offset each year by the costs of servicing and the amortization expense.

Entry	Servicing Rights	\$56,527
	Valuation Reserves for Servicing Rights	\$56,527

5. The servicing income in the first year would be approximately \$135,000 and the estimated expense would be \$35,000. The amortization would be \$5,653 (10% of \$56,527). The amount of the servicing income will decrease each year as the amount of the mortgage balances decrease.

Entries	Cash (or Accrued Receivable)	\$135,000
	Servicing Income	\$135,000
	Servicing Costs	\$35,000
	Cash (or Accrued Expenses)	\$35,000
	Amortization Expense	\$5,653
	Accumulated Amortization	\$5,653

Also see the example at paragraph 50 for details of the sale of loans with servicing retained by the seller.

Swap Example from BankExec

IAS 39

3. Recognition

3.1 Initial recognition

3.1.1 Enterprise recognizes financial asset or financial liability when, and only when, it becomes a party to the contractual provisions of the instrument. The enterprise will have the legal right to receive, or a legal obligation to pay, cash.

3.1.2 Trade date versus settlement date. See chart at paragraph 34. The enterprise will choose between two methods and then be consistent with all categories of financial assets.

3.1.2.1 Trade date is date enterprise commits to purchase the assets.

3.1.2.2 Settlement date is the date the asset is delivered. Any change in fair value between the trade date and the settlement date is recognized in net profit or loss (for trading or available for sale categories) or in equity (for available for sale). See also paragraph 33.

3.1.3 The financial asset should be derecognized when, and only when, the enterprise loses control of the contractual rights for the asset. Loss of control occurs when the enterprise realizes the rights to benefits in the contract, the rights expire, or it surrenders the rights.

3.1.3.1 On derecognition, the difference between the carrying amount and the sum of proceeds received or receivable plus or minus prior adjustments to reflect fair value should be included in net profit or loss for the period.

3.1.3.2 Accounting for collateral is described at paragraphs 44-46. Paragraph 45 describes a repo agreement.

3.1.3.3 Sale of loans with servicing retained is described in paragraphs 47-50. Additional sales of loans are also described in 51-56.

3.1.4 A financial liability should be derecognized when, and only when, it is extinguished (discharged, cancelled, or expired). See paragraph 57 to 65.

IAS 39

4. Measurement

4.1 Initial measurement of financial assets and liabilities

4.1.1 When recognized, record at cost, including transaction costs.

4.2 Subsequent measurement of financial assets

4.2.1 At fair value, without deduction for transaction costs. Does not include loans originated, held to maturity investments and other financial assets that do not have a quoted market price and whose fair value cannot be reliably determined.

4.2.2 The excluded items in 4.2.1 with a fixed maturity should be measured at amortized cost using the effective interest rate method (discounted cash flow or IRR). If no fixed maturity, measure at cost.

4.2.3 Financial assets can not be categorized as held to maturity if any one of the following conditions are met:

- a. has intent to hold for only an undefined period;
- b. is ready to sell the asset in response to changes in market interest rates or risks, liquidity needs, changes in the availability of and the yield on alternative investments, changes in financing sources or terms, or changes in foreign currency risk; or
- c. the issuer has the right to settle the asset at an amount significantly below its amortized cost.

4.2.4 The enterprise should establish a policy which covers the guidelines necessary to classify the asset as held to maturity. Paragraphs 83 to 89 address some of the considerations necessary to determine if the enterprise can classify the asset as held to maturity.

4.3 Subsequent measurement of financial liabilities

4.3.1 All financial liabilities, other than held for trading and derivatives, should be measured at amortized cost.

4.3.2 Financial liabilities held for trading and derivatives should be measured at fair value. See paragraph 93 for exceptions.

4.4 Fair value measurement considerations

4.4.1 Paragraphs 95 to 102 covers the various considerations to determine how to measure fair value.

4.5 Gains and losses on remeasurement to fair value

4.5.1 For financial assets and liabilities not part of a hedging relationship, the gain or loss from a change in fair value is reported as follows:

- a. held for trading gains and losses should be included in net profit or loss for the period;
- b. available for sale assets should be either
 - include in net profit or loss for the period; or
 - recognized directly in equity, though the Statement of Changes in Equity, until the financial asset is sold, collected, or otherwise disposed of, or impaired, at which time the cumulative gain or loss previously recognized in equity should be included in net profit or loss for the period.
 - Once the choice is made, the same policy should be applied to all available-for-sale financial assets.

4.6 Gains and losses on financial assets and liabilities not remeasured to fair value.

4.6.1 For assets and liabilities carried at amortized cost, a gain or loss is recognized in net profit or loss when the asset or liability is derecognized or impaired. If a hedging relationship, other rules apply (see paragraphs 121-164).

4.7 Impairment and uncollectibility of financial assets.

4.7.1 Impaired if the carrying cost is greater than its estimated recoverable amount. If evidence exists, assess each group of assets carried at amortized cost or remeasured at fair value.

4.7.2 The loss on assets carried at amortized cost is the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the instrument's original effective interest rate. Also see paragraphs 114 and 115. Reversals are included in the net profit or loss for the period.

4.7.3 The loss on assets remeasured to fair value and previously adjusted through equity results in an adjustment to the equity amount for the amount of the impairment. The loss would be recorded in net profit or loss for the period. The amount of the loss is the difference between its cost and current fair value or recoverable amount less any impairment loss previously recognized in net profit or loss. Reversals are included in net profit or loss for the period.

4.8 Hedging

4.8.1 See paragraphs 121 to 165.

4.8.2 Three types of hedges:

- a. fair value hedge - against the exposure to changes in fair values of the assets or liabilities and that will affect reported net income;
- b. cash flow hedge - against the exposure to variability in cash flows that are attributable to a particular risk or a forecasted transaction and that will affect reported net income or loss;
- c. hedge of a net investment in a foreign entity as defined in IAS 21.

4.8.3 A hedging relationship qualifies for hedge accounting if, and only if, all the following conditions are met:

- a. at the time of the hedge there is formal documentation of the relationship and the enterprise's strategy and objectives. All details of the hedge should be identified.
- b. the hedge is expected to be effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk;
- c. for cash flow hedges, the forecasted transaction must be highly probable and must present an exposure to variations in cash flows that could ultimately affect reported net profit or loss;
- d. the effectiveness of the hedge can be reliably measured; and
- e. the hedge was assessed on an on-going basis and determined to have been highly effective throughout the financial reporting period.

4.8.4 Assessing hedge effectiveness is discussed in paragraphs 146 to 152.

4.8.5 Accounting for hedges is discussed in paragraphs 153 to 165.

4.8.5.1 Fair value hedges - Gains or losses from remeasuring the hedging instrument to fair value are recognized immediately in net profit or loss. The carrying amount of the hedged item should be adjusted for gains or losses on

the hedged item with the net profit or loss recognized immediately.

- 4.8.5.2 Cash flow hedges - gains or losses on the portion of the hedging instrument determined to be effective should be recognized directly in equity through the Statement of Changes in Equity. The gain or loss on the ineffective portion is usually reported immediately in net profit or loss if the instrument is a derivative. Also see paragraph 159 for a more detailed explanation.

IAS

5 Disclosures

5.1 Most of the disclosures required for IAS 32 also apply to IAS 39.

5.2 In addition, the following should be included:

5.2.1 Description of the financial risk management objectives and policies, including hedging policy.

5.2.2 for three kinds of hedges, include the following:

- a. description of the hedge;
- b. description of the designated hedge instruments and the fair values;
- c. the nature of the risks being hedged; and
- d. for forecasted transactions, the periods in which the forecasted transactions are expected to occur, when the net profit and loss will be determined, and previously used hedges for forecasted transactions.

5.2.3 If gains and losses recognized in the Statement of Changes in Equity, disclose the following:

- a. the amount recognized in equity in the current period;
- b. the amount removed from equity and reported in net profit or loss for the current period; and
- c. the amount removed from equity and added to cost or carrying amount of the asset or liability in the hedged forecasted transaction in the current period.

5.2.4 Disclose significant items of income, expense, and gains and losses resulting from financial assets and liabilities

Final Examination - International Accounting Standards

Name _____ Date _____

1. True___ False___ The most important reason for using IAS is to improve transparency to force businesses to face up to economic reality. (True)
2. List the two underlying assumptions for the preparation of IAS compliant financial statements. (Accrual basis and going concern)
3. True___ False___ Another term or word for equity is stockholders' equity or shareholders' equity. (True)
4. True___ False___ A complete set of IAS compliant financial statements will include the Balance Sheet, the Statement of Income, the Statement of Changes in Stockholders' Equity and Disclosures of the Accounting Policies and Notes. (False - you also need a Cash Flow Statement)
5. True___ False___ Compliance with all requirements of each standard is not necessary to have a set of financial statements in compliance with IAS. (False)
6. List the three types of activities used in the presentation of Cash Flow Statements. (Operating, Investing and Financial)
7. List the two methods for preparation of Cash Flow Statements. (Direct and Indirect)
8. True___ False___ Cash and Cash Equivalents includes the Reserves Required by the Central Bank. (False)
9. True ___ False___ On the Income Statement, income from ordinary activities includes all normal operations and the extraordinary items of income and expense. (False - the extraordinary items are on a separate line item.)
10. True ___ False___ Events that occur after the balance sheet date are not required to be reflected in the balance sheet or the disclosure notes, regardless of the amount of the effect. (False - it should be disclosed if it is material)
11. List three items of deferred taxes payable or recoverable in future periods. (Temporary differences, carry forward of unused tax losses, and carry forward of unused tax credits)
12. A deferred tax asset that can be recovered in a future period can be set up on the books as an asset. Give an example of a deferred tax asset. (Unused tax losses and unused tax credits available for carry forward)
13. True___ False___ Application of IAS 15, "Information Reflecting the Effects of Changing Prices," is mandatory and banks must apply it to their financial statements. (False)
14. True___ False___ As of January 1, 2001, IAS 16 still applies to rental investment properties. (False - rental property is not covered by IAS 40)
15. True___ False___ Substance over form has no effect on the preparation of IAS compliant financial statements because the laws of Russia and the Russian Accounting Standards must be followed. (False - substance over form must be used in several of the IAS standards)

Final Exam in IAS

Page 2

16. When making a determination of the present value of the minimum lease payments for leased assets, which of the following is not needed? (circle the answer)
 - a. Total amount of payments over the life of the lease.
 - b. The term of the lease.
 - c. The discount factor or internal rate of return.
 - d. The useful life of the leased asset. (circle)
17. True___ False___ When applying the IAS, income is recognized only when it is received. (False - it is recognized when the event occurs)
18. When an acquisition is made, the excess in the fair value of assets over the liabilities can result in the recognition of another asset. What is the name of this asset? (Goodwill)
19. True___ False___ The cost of borrowing to build a new bank headquarters office is not a cost of the asset but will always be an expense. (False - the cost is added to the cost of the asset until it is put into use)
20. True___ False___ Related party disclosures are no longer required and will not help investors make a decision to invest in the business. (False - are required)
21. True___ False___ IAS 25 will still apply to investment property after January 1, 2001. (False - it is replaced by IAS 40 as of that date)
22. List at least three of items that reflect whether or not control exists for the purpose of consolidated financial statements. (Ownership of more than 50%, voting rights over 50%, policies, board of directors, voting rights of directors)
23. True___ False___ When making the determination of whether an investment is applicable to IAS 28, the amount of ownership holding must be between 25% and 50%. (False - 20% to 50%)
24. True___ False___ The application of IAS 29 to the preparation of IAS financial statements is not required if inflation is less than 100% over a two year period. (False - over a three year period)
25. When applying IAS 30 to the statements for the bank, there is a need to disclose certain contingencies that are relevant to banks. List three of these off-balance sheet contingencies. (commitments to extend credit, direct credit substitutes, performance bonds, standby letters of credit, trade related short-term, sale and repo agreements, interest and FX related items as included in paragraph 26.4.4)
26. True___ False___ When applying IAS 32, the inventories and patents are included as financial assets. (False - they are not)
27. Earnings per share are calculated in two ways. List the two methods. (Basic earnings per share and diluted earnings per share.)
28. True___ False___ When an interim statement is prepared, a condensed set of financial statements can be presented as long as all material items are included. (True)
29. List the two methods of measurement of recoverable amount when determining whether an asset is impaired. (net selling price and value in use)
30. True___ False___ If an asset is impaired, the lowest recoverable amount is always used when making the adjustment. (false - the higher of the two methods is used)

Final Exam in IAS

Page 3

31. True___ False___ When making a decision to apply IAS 37, a provision will be required for all possible obligations, without regard to the probability of an outflow of cash. (False - only present obligations with a probable outflow of cash will need a provision)
32. True___ False___ When determining the life of an intangible asset, the maximum useful life is limited to ten years. (False - there is no limit in IAS except for goodwill with a suggestion of a maximum of 20 years)
33. List the four categories of classifications for financial instruments. (trading, available for sale, loans and receivables originated with no intent to sell, and held to maturity)
34. True___ False___ IAS 40 includes investment property and owner-occupied property used in the normal business. (False - not owner-occupied property)

Checklists for Seminar Preparation and Presentation

During the term of the project we presented many seminars and lectures. In an attempt to organize the seminars more efficiently, we developed the following three checklists for pre-production, production and post-production of seminars.

PRE-PRODUCTION CHECKLIST FOR SEMINARS AND WORKSHOPS

Tasks to be done before the course begins.

General

Determine the course topic.

Contact DAI/Bethesda. for the instructor's name.

Confirm the dates of the course.

Prepare course announcements one month in advance of the course.

Deliver course announcements to or e-mail the following institutions:

CBR -- Deputy Governor, Chief Accountant;
DAI/B-- Project support staff;

Invite USAID representatives to attend the opening of the session.

Prepare separate files for instructor(s) and course.

Instructors

Obtain CV/resume of the instructor.

Contact the instructor about course material and any necessary textbooks.

Determine how tests are will be graded. The instructor will grade the quizzes and/or exams.

Ask instructor about lodging preferences, e.g., smoking/non-smoking room; low or higher floor. Does he have any special dietary needs and/or sleeping accommodation requirements?

Find out if the instructor will be bringing his own laptop and/or printer, or if one will have to be provided.

Send economic and cultural information on the country to the instructor.

Obtain country clearance from USAID for the instructor(s).

Arrange for obtaining visa for instructor(s).

Make travel arrangements for the instructor(s) 30 days in advance.

Confirm travel arrangements for the instructor.

Provide a complete, confirmed itinerary to the instructor(s) by e-mail or FAX.

Confirm hotel arrangements.

Telephone follow-up with instructors a week in advance of the seminar to clear up any final questions or details.

Arrange local transportation, if necessary, including pick up at the airport. Provide the driver with all information pertaining to the instructor's arrival – flight number, hotel reservation number, etc., and a name sign for the driver to wave.

Facility

Reserve training room and necessary equipment.

Prepare tent cards with the names of the attendees for the tables or desks.

Arrange a reception to be held before the course begins to announce the project, give handouts to attendees, and allow the participants to meet. Representatives of USAID, the participating banks, other government agencies may deliver introductory speeches. Confirm these arrangements two days before the reception.

Make arrangements for the party/reception to be held when the course is finished. Diplomas will be handed out at this time.

Equipment

If necessary, arrange for a laptop for the instructor(s). Ensure that the necessary software is loaded on the laptop, e.g., BankExec.

Provide a camera for class photos

Ensure that the necessary equipment will be in the training room and that it functions – extension cords, flipchart, white board, markers, erasers, back-up bulbs for the overhead projector, etc.

Buy calculators for the course participants.

Course Materials

Obtain course materials, reference material, handouts, overheads, etc.

Translation of course materials

Editing the translation of course materials

Copy all course materials, enough copies for participants, instructor, interpreter, course files and USAID.

Interview and hire course interpreters, if necessary

Select local instructors, if required

Prepare a list of the registered participants by name, title, and bank.

Prepare diplomas and/or certificates:

Determine which officials are going to sign the diplomas.

Thin strips of fabric in national colors or tiny national flags for diplomas.

Print the diplomas and have them signed.

Frame or not as instructed.

Prepare contact information for instructor(s) to give to participants at the end of the course.

PRODUCTION CHECKLIST

Tasks to be done during the seminar.

Pass out course material and other relevant handouts at the reception before the course, or pass out the material the first day of the course if there is no reception.

Set out tent cards on tables or desks.

Check the required equipment each morning before the seminar begins, consider the needs of the instructor and the interpreter.

Have a blank attendance list ready each day at the beginning of the seminar for the course participants to sign. Collect it at the end of the day when participants have signed it. Do not let it lay about during the day.

Ask the participants to provide their telephone number, fax and address; prepare a contact list and give it to the participants at the end of the course.

Take a picture of the class with the instructor early in the course, and have it developed and printed in time to be given to the participants at the end of the course.

Two days before the end of the course, confirm arrangements for the refreshments and ceremony at the end of the course

The last day of the course, have the participants fill out the course evaluation form.

The last day, give the participants the instructor's contact information and the attendees' contact information.

Have diplomas ready to be presented to successful participants at the end of the course.

Material to Handout

Have ready:

- A list of web sites relevant to the course
- Copies of the course material.
- A list of registered participants.
- Blank attendance forms.

Instructor

Make copies of the instructor's passport and tickets, one for the file and one for him.

Ensure that the instructor has access to internet service provider from his laptop.

Obtain a copy of the final examination from the instructor. Make enough copies for the participants, and keep the exam secure.

Arrange weekend tours for instructor(s) if they wish.

Confirm the instructor's return flight two days before he is to leave.

POST-PRODUCTION CHECKLIST

Tasks to be finished as quickly as possible after the course.

Prepare an attendance report – the banks and respective officials, who have participated in the course

Review of the results from the final test and note pass or fail on the attendance report.

Summarize the results of the course evaluation forms and forward to USAID and DAI/Bethesda. Keep the originals at the project office.

Press release to the media describing the course and the participants

Send letter to the Human Resources Director and the CEO of the participating banks, congratulating the most successful course participants.

Collect any outstanding tuition fees as soon as possible.

Pay any outstanding amounts relative to the course immediately.

Critique on the pre-production and production stages

Comprehensive check of course materials for suggested improvements.

Keep a copy of the course materials, in English and translated, on floppy disks

Scope of Work for Research Project – Yassin

The following four pages is the summary of the research project agreed to with USAID as an add-on to the project.

Non-market sector in the Russian economy Research Project

Summary

The Russian economy has reached a new stage of the transition process, and structural reforms are becoming a priority task of the Russian Government for the next few years. One of the main problems of the modern Russian economy is the existence of a significant non-market sector.

Professor Yassin and a group of experts from the Higher School of Economics (HSE) and the Expert Institute propose to implement a project designed to conduct research of the non-market sector in the Russian economy on the basis of economic efficiency criteria. Such project will be a first example of applied research in the modern history of Russia.

It would allow to get a clear understanding of the nature and scope of work required to reform and liquidate the non-market sector in the Russian economy and make more informed and efficient decisions relating to the use of foreign technical assistance, direct foreign investments and credits.

Such applied research is very useful for the development of a realistic state program of reorganisation and/or liquidation of insolvent enterprises on the condition that relevant social problems (unemployment, migration of population, low incomes of household, etc.) are resolved. In addition, it will be possible to evaluate the actual competitiveness of

enterprises, which will be covered in the research, under rigid budget constraints and relative prices existing in the world economy.

The purpose of the above research project is, firstly, to assess the actual structure of the Russian real sector presented as a proportion between two basic types of enterprises, namely:

- 1) enterprises which have already adapted to the transition economy's conditions and environment and are using their resources efficiently (hereinafter referred to as the "market sector"), and
- 2) enterprises that have not yet adapted to the new commercial environment of the transition economy and are using their resources inefficiently. The enterprises of this group are highly unlikely to successfully develop in future (such group being referred to as the "non-market sector").

Secondly, the proposed research is designed to determine why the non-market sector continues to exist and identify factors which influence the size and characteristics of the non-market sector.

In the framework of the project implementation the following research problems could be solved:

- development of a method for defining of the gross added value parameter (at the enterprise level) in line with practices accepted worldwide,
- selection of a representative sample of industrial enterprises and calculation, together with the Goscomstat, of the gross added value in the industrial sector in order to estimate a percentage of enterprises which produce negative added value,
- studying of quantitative characteristics (e.g. dynamic characteristics) of the above representative sample of industrial enterprises,

- measurement of losses of the Russian economy resulting from the existence of the non-market sector,
- measurement of effects of such payment instruments as barter and the like which are distorting actual economic processes,
- conducting interviews with managers of the enterprises included in the representative sample in order to identify the most important factors and characteristics of the non-market sector in the Russian economy, and
- estimation of subsidies (e.g. subsidies provided by the energy sector) which the industrial sector receives due to existing relative prices and non-monetary types of payment.

On the basis of the above methodology, it would be possible to classify enterprises under review as falling within the following three categories:

- 1) enterprises producing positive added value,
- 2) enterprises producing added value which is close to zero, or
- 3) enterprises producing negative added value.

Initial information for calculating the added value of an enterprise can be found in the enterprise's report submitted to the state statistical bodies (a division of Goscomstat) in the Form ? 5-Z. The researchers are going to use two methods of calculation: one based on expenses and the other based on production.

Due to obvious differences between statistical data presented in the Form ? 5-Z and actual business performance (caused by the specifics of the Russian accounting standards) it would be reasonable to make some adjustments on order to determine the actual results of

enterprises' business activity. Due to such adjustments it may be possible to measure the efficiency of the Russian enterprises more precisely than on the basis of official statistics.

It is possible to collect information required to make such adjustments concurrently with the collection of other statistical data: there is an agreement with Goscomstat whereby a questionnaire is to be sent to all enterprises which will be selected for this research. Data received from the relevant responses will be studied using certain statistical methods (cluster analysis, MANOVA, MANCOVA, etc.), and the results will be compared with the data contained in statistical reports.

The researchers are going to include in the research about 2,000 Russian enterprises from various industries. The group of Professor Yassin is able to implement the above plan because HSE has significant experience in the field of applied economic research. In addition, the group has entered into an agreement with Goscomstat on obtaining necessary statistical information subject to certain confidentiality conditions.

Lessons Learned

Always share information and encourage the counterparts to do the same.

We are trying to achieve transparency. CBR had no copy of the TOR or final work plan (even though we had provided the work plan to our direct counterpart). Provide copies to all members of the counterpart team. We later provided copies of quarterly reports so the counterpart knew what we were saying to USAID.

Coordinate with other projects.

We shared information we had developed and contacts we had made with PwC and other projects involved in banking reform and accounting reform. We may have saved some time for the other projects because they didn't have to go find the same information again. We also tried to find out what had been done before we arrived. We felt we could adopt whatever was useful instead of trying to re-invent the wheel. There was very little information available.

Be flexible!

The law didn't allow the changes that were expected by USAID, Tacis, World Bank and IMF. We had to find a way to implement IAS. We got around the restriction in the law by recommending to the CBR that they issue instructions and guidelines for commercial banks to report to the CBR using IAS compliant financial statements and data.

No matter what you expect, it will probably be different than you planned.

Request and insist on regular meetings with the counterparts.

We had some initial problems with some of the people at the CBR. Information was not being shared among the various levels within the CBR. If we had insisted on the meetings with the Chief Accountant, the initial problems would have been eliminated and we may have been more productive.

Be proactive when trying to get something done.

There are a large number of people at the CBR who are not accustomed to using lead-time to plan some activities. They did not understand some of what we were trying to achieve nor did they have the same sense of urgency that we had with our project.

Presentation to USAID

On August 8, 2001 a presentation was made at the offices of USAID/Russia in Moscow. The presentation was prepared using Power Point. A hard copy of the presentation is enclosed with this report. An electronic version of the presentation is also forwarded with the electronic version of this document which is in Microsoft Word.